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Politics this week

May 22nd 2003
From The Economist print edition

Terror's week

AP

In **Casablanca**, 12 suicide bombers killed 29 people in five synchronised blasts on a hotel, a Spanish club, the Belgian consulate and a Jewish cultural centre. The victims were mostly Moroccan but also Spanish, French and Italian. The Moroccan authorities, who are interrogating two suspects, speak of international terrorists working through local Islamic vigilantes.

See article: Moroccan suicide bombings

America, along with Britain and Germany, temporarily closed their embassies and consulates in **Saudi Arabia**, after a Saudi warning that electronic "chatter" had been heard about new planned attacks. America also heightened security throughout the United States. British Airways cancelled all flights to **Nairobi** after reports of possible ground-to-air attacks.

See article: The return of al-Qaeda?

An Arabic TV station broadcast a tape, reportedly from **al-Qaeda's** number two, Ayman al-Zawahri, urging attacks on the interests of America, Britain, Australia and—perplexingly—Norway.

See article: Al-Qaeda's new war

America and Britain introduced a new **Security Council** resolution to end sanctions on Iraq, and legitimise the occupying powers' authority. The new draft, which they expected to be passed on May 22nd, gives the UN a slightly stronger role in Iraq, including the appointment of a special representative.

See article: Making peace with the UN

In Baghdad, the American authorities made it clear that **Iraq's** interim administration, which is expected to be appointed in the next couple of months, will have a consultative role only.

See article: Baghdad faces anarchy

NATO ambassadors agreed that the alliance would help **Poland's** peacekeeping forces in a part of Iraq.

Israel suffered five suicide-bomb attacks in three days: in Jerusalem (where seven people were killed on a bus), northern Israel and the occupied territories. Ariel Sharon postponed a scheduled visit to President George Bush. The Israeli army sealed towns and villages in the West Bank and Gaza but refrained from other retaliation to give Mahmoud Abbas, the Palestinians' new prime minister, "a chance".

See article: Israel and the Palestinians

More than 500 people were reported killed in an **earthquake** in northern Algeria, near the capital, Algiers.

Zimbabwe illegally deported *The Economist*'s (and *Guardian*'s) man in Harare, Andrew Meldrum. He was the last foreign correspondent based in the country.

See article: Zimbabwe evicts our correspondent

In poor health

Another health scare for **Canada**. Just as its SARS outbreak was waning, a cow in Alberta was diagnosed as suffering from BSE or mad-cow disease. The United States immediately banned imports of Canadian beef and animal feed.

See article: Threats, real and less so, to Canada's economy

Néstor Kirchner, **Argentina's** president-elect, announced his cabinet appointments. He retained Roberto Lavagna as economy minister.

AP

See article: Argentina's new president

In a message on **Cuba's** independence day, George Bush urged democracy and respect, but did not announce any tightening of the United States' trade embargo against the island.

See article: Cuba's crackdown, and the United States

In **Colombia**, three army officers and 37 troops were arrested, and over 100 were on the run, after they discovered and stole at least $14m in banknotes, apparently accumulated by FARC guerrillas as profits from kidnapping and cocaine.

Small bang

The American Senate voted to permit research on "**mini-nukes**", but required it to get the approval of Congress before developing them. Such research had previously been banned but Donald Rumsfeld, the defence secretary, argued that little nukes might now be useful here and there.

Christine Todd Whitman, the head of the Environmental Protection Agency, and **Ari Fleischer**, the White House press secretary, announced that they were leaving. Mr Fleischer wanted to spend time with his wife; Mrs Whitman wanted to stop being a voice in the wilderness.

The House and Senate agreed on a **tax cut** of $350 billion over ten years, less than half what George Bush originally wanted.

See article: Squaring the circle

Rebel routing?

A force of 45,000 troops and police opened a campaign against separatists in **Indonesia's** western province of Aceh after a peace deal had failed. The army expected to take up to six months to defeat the rebel force of some 5,000 fighters. But that may be optimistic: the rebellion has been going on for 27 years, during which more than 10,000 people have died.

See article: War on the separatists

Armed police broke up an opposition rally in Phnom Penh, raising fears that demonstrations will not be tolerated in the run-up to **Cambodia's** general election on July 27th.

In a "misunderstanding" American soldiers guarding their embassy in **Kabul** shot dead four Afghan soldiers who were leaving a nearby building.

See article: Karzai takes on the warlords

Eighteen schoolchildren died when an overloaded ferry capsized in **Vietnam**.

Taiwan reported a daily rise in cases of the deadly infection SARS, bringing the total to 418. But in mainland China, Hong Kong and Singapore the epidemic appeared to be waning.

India has refused to allow a Hong Kong firm, Hutchison Port Holdings, to bid for a proposed $192m container terminal near Mumbai, for security reasons. It is too near naval establishments, India says.

Belgium swings right

Belgium's Flemish Liberals, led by the country's incumbent prime minister, Guy Verhofstadt, did best in a general election, so the ruling coalition looks set to stay in office. But the far-right Vlaams Blok gained ground, getting nearly a fifth of the vote in Flanders and a third in Antwerp, Belgium's second city.

See article: Belgium's divisive national politics

The **Swiss** rejected proposals, put to referendum, to renew a moratorium on building nuclear-power plants and to phase out nuclear power.

AFP

See article: The Swiss are a shade less green than before

At their annual party congress, **France's** despondent Socialists proved reluctant to embrace a more free-market philosophy.

See article: France's Socialists

In the **Netherlands**, the Christian Democrats, Liberals and D66 agreed on a programme of government. The outgoing prime minister, the Christian Democrats' Jan Peter Balkenende, will head the coalition.

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Business this week

May 22nd 2003
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The diminishing dollar

The **dollar** hit a four-year low against the euro, nearing the rate at which the single currency was launched in 1999. “The economy continues to be buffeted by strong cross-currents,” remarked Alan Greenspan, chairman of the Federal Reserve. He hinted that interest rates would be cut again if deflation threatened.

See article: Squaring the circle

Germany is at high risk of **deflation**, as are Taiwan and Hong Kong, but the risk of falling prices in America is low, according to the IMF. Unsurprisingly, Japan's deflationary spell is expected to persist.

While the euro area's two other big economies founder, **France's** grew by 1% over the previous quarter at an annual rate.

Mighty fine

WorldCom agreed to pay $500m, America's biggest corporate fine, to settle charges that it had overstated profits by $11 billion since 1999. The accounting fraud drove America's second-largest long-distance telephone company into Chapter 11 bankruptcy.

See article: Crime pays

Matthew Whitley, a former **Coca-Cola** executive, filed a lawsuit claiming that managers of the soft-drink firm ran one division as “an illegal racketeering enterprise”. Coke says that the accusations of deceptive marketing and accounting, and selling contaminated products came after it refused to pay Mr Whitley $44m to keep quiet.

Britain's shareholders won a notable battle in their offensive against executive pay. **GlaxoSmithKline's** investors narrowly rejected a resolution granting the drug firm's chief executive, Jean-Pierre Garnier, a severance package worth over £20m ($33m), though the vote is non-binding. A reward for failure, moaned shareholders; a “very complex situation”, soothed Sir Christopher Hogg, GSK's chairman.

See article: Executive pay packages should not reward failure

Tweedy, Browne, a big shareholder in Lord Black's **Hollinger International**, publisher of Britain's *Daily Telegraph*, filed a letter with the SEC ahead of the firm's annual meeting demanding the return of some $73m it alleges was unfairly paid to company bosses.

Universal coupling

Edgar Bronfman is planning to lead a consortium hoping to buy the American media assets of **Vivendi Universal**. The Canadian tycoon sold them to the French media giant three years ago as part of Vivendi's *euro*33 billion ($31 billion) acquisition of Seagram.

See article: Diverging again

EMI reported an annual profit of £319m ($493m) even though its music sales followed the worldwide trend and fell by nearly 13%. The company blamed music piracy for the dip.

The high cost of next-generation mobile telephony left **mmo2** with a mammoth annual pre-tax loss of £10.2 billion ($15.8 billion). Britain's fifth-largest mobile operator wrote down £9.7 billion, much of it to account for the diminishing value of its 3G licences in Britain and Germany.

Up in smoke

The World Health Organisation adopted an **anti-smoking** treaty after spending years persuading big rich tobacco-producing countries to adopt measures to reduce tobacco-related deaths. Approval will bring bigger health warnings and advertising bans.

A Florida appeal court reversed a decision holding America's **big tobacco** companies liable for the illnesses of 700,000 of the state's smokers. The 2000 ruling had required the firms to pay $145 billion in damages.

See article: The outlook for smoking

Broken banks

Japan's government bailed out **Resona** after the country's fifth-largest bank failed to meet tough new capital requirements. The government promised a “hands-off” approach to Resona, suggesting the usual temporary fix rather than a long-overdue radical attack on the banking sector's huge bad-loan problem.

See article: The troubling rescue of Japan's fifth-biggest bank

WestLB reported a pre-tax annual loss of *euro*1.7 billion ($1.6 billion). The German state-owned bank began investigations of its project-financing team run by Robin Saunders, a supposedly hot-shot banker; much of the loss relates to hefty write-downs after a refinancing of Box Clever, a British TV-rental firm.

OM Gruppen, one-time suitor of the London Stock Exchange in furtherance of its pan-European aspirations, picked up a smaller prize. The operator of Sweden's stock exchange will pay *euro*242m ($282m) for HEX, its Finnish rival. It invited other Scandinavian and Baltic exchanges to join forces and create a pan-regional business.

Joint venture

Zimmer, an American company best known for propping up the infirm with its artificial joints, counterbid for **Centerpulse**, a Swiss orthopaedic-device maker. Zimmer trumped an offer from Britain's Smith & Nephew with a bid valuing Centerpulse at SFr4.1 billion ($3.2 billion).

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The right to be beautiful

May 22nd 2003
From The Economist print edition

And shall not loveliness be loved forever? Yes, if you can afford it

OF COURSE, it is ridiculous. What sane person would put metal rings round her neck to stretch it like a giraffe's, or lace her corset so tight that she fainted, or allow her feet to be bound to make them tiny? How backward, how primitive. Completely different, obviously, from the woman who pays huge sums to have her breasts surgically enlarged; or the man who takes drugs to give him an athlete's torso; or the rich, modern men and women who spend $160 billion a year on beauty products whose impact on the appearance is sometimes, um, unproven. From stilettos to diets to cosmetic surgery, women (and, increasingly, men) go to great lengths and huge cost to make themselves better looking. And now, advances in technology allow people to change their appearance not just for an evening out but for ever.

After you with the tea-tree oil

Does it matter if human beings change their bodies in more fundamental ways than our grandparents ever dreamt of? The reasons for change go well beyond the pursuit of beauty, of course. Not only do athletes reshape themselves to do better at sport: Tiger Woods recently had an operation on his eyes to allow him to judge distances better. The sexually discontented can now alter their gender in ways that go well beyond the acquisition of a nice frock and a bit of padding. But it is beauty that dominates the remodelling business and that raises the toughest questions.

The search for beauty has always seemed frivolous to some, and not just to those of the male persuasion. Puritans, who once squawked about the evils of lipstick and facepaint, now have fresh moral dilemmas to wrestle with. If the beauty business deceives people into spending money uselessly or harmfully, should it be stopped from doing so? Some fret that the preoccupation with appearance is leading to a shallower society, and to a host of social horrors from family breakdown to eating disorders. Others fear that beauty firms are trying to blur the line between drugs and cosmetics, or complain that tampering with the incline of one's nose is the first step on a slippery slope to tampering with one's genes. And of course, there are always the poor: should they be exposed to marketing baloney that may persuade them to spend money on empty promises to stop time's hand?

Only in the case of the young are there grounds for special intervention—although parental responsibility ought really to do the job. Until their bodies stop growing, teenagers should not to be allowed to change them in permanent ways that may turn out to be harmful. By all means straighten their teeth and even their noses, but leave puppy fat alone. Let them pierce their ears or indeed their tongues, if they must, but ban the tattoos and hold that graduation present of breast enlargement.

But what of adults, who behave little more rationally than teenagers in this regard? Perhaps governments should get the makers of those creams made of dolphin serum and goose fat to list the ingredients on the pot, as if they were breakfast cereals. Big beauty companies, experts at deception, have the money and power to play on people's hopes and fears (see article). However, choice and scale are powerful bulwarks against deception. The creation of giant beauty companies means not only lower prices and cleverer innovations, but global brands whose reputations need protection. As for the poor, sales of beauty products tend to take off when incomes rise. Lipstick may be an indicator of economic progress. And the freedom to believe nonsense about getting rid of wrinkles is one of the most basic human

liberties.

The more difficult questions will arise when it becomes clear that some of the promises actually come true. Good-looking people have great advantages over the ugly. For example, they earn more: when Barry Harper of London Guildhall University looked at 11,000 British 33-year-olds, he found that the pay penalty for unattractiveness was around 15% for men and 11% for women. Overweight women earned 5% less than average, especially in clerical and secretarial jobs. Good looks in both sexes mattered especially, he found, in sales jobs, where the seller meets the buyer. Another study, of 289 Dutch advertising firms, found an association between good-looking executives, higher revenues and business success.

Not only do looks help in the job market. In both sexes, they help in the marriage market. Studies show that handsome folk are more confident. It is a cruel fact that good looks can make you a better parent: babies are attracted to prettier people. Good looks remove some of life's irritations: another study found that people rated as more attractive feel more entitled to better treatment and are less willing to be kept waiting; another, that good-looking women with a flat tyre get rescued first. And a nice face helps to get people out of trouble: a recent University of Oslo study found that university students awarded criminals sentences which were 20% lighter if they were told that the villains were “handsome” or “pretty”.

If a bit of lipstick can keep you out of jail, or waxing your mustache can land an extra 15% in earnings, then who would not pay for successful beauty treatments? If genetic engineering ever catches on, it will be hard to draw a firm line between correcting defects and enhancing characteristics. It would be irrational for parents who love their children not to want them to be more beautiful as well as healthier and more intelligent.

The ugly underclass

But if society believes that government should aim to give citizens equal opportunities, might beauty be a right that society can be legitimately asked to pay for? The poor once looked very different from the rich: they were worse fed, worse clothed, worse washed and had less access to medical and dental care. Those days are gone, at least in the developed world. But bat ears or a cleft lip can still make a teenager's life a misery. The World Health Organisation has broadened its definition of health to include psychological well-being. Stand by for the moment when public policy has cut out the most striking sources of inequality, and conventions of cosmetic surgeons announce that their craft can excise the remainder.

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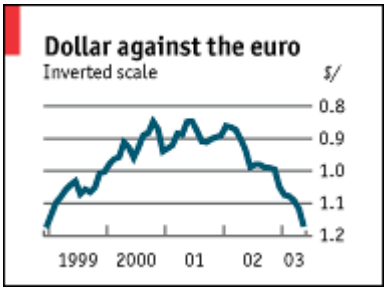
The dollar

Diminished

May 22nd 2003
From The Economist print edition

Beer should be strong. Currencies, not necessarily

Get article background



THE dollar has been sliding in currency markets for months. This week it fell to $1.17 against the euro—roughly where it stood against Europe's new currency when the euro was launched at the start of 1999. For most of the past four years, Europeans have been a little embarrassed, and Americans a little smug, about the performance of their currencies. This week, as that $1.17 threshold came into view, sentiment switched, and a flurry of concern moved through America's financial markets. Now it is the euro's turn to hold its head high and the dollar's to make feeble excuses; the sudden crisis even warranted explanatory graphics and grave-looking commentators on American network news.

Gosh. Are things really that bad? Not quite. The my-currency-is-stronger-than-yours genre of financial commentary is a disgrace to economics and, more important, to common sense. A strong currency has advantages, no doubt: it confers additional purchasing power (because it makes imports cheap). But it also puts a burden on many industries (by making exports dear) and, if demand in the economy is already deficient, an appreciating currency can make a slow-moving economy stall altogether. Nor is a currency's strength a reliable indicator of international confidence: despite the dollar's slide, few doubt that America's economic prospects, short- and medium-term, are better than Europe's.

Explaining currencies' short-term movements is a game for Wall Street analysts and other storytellers. What one can say, however, is that global economic stability calls for a gradual reduction in America's enormous current-account deficit (and its consequent heavy demands on the global capital market). A cheaper dollar will help in that. By giving a push to weak demand, it will also help to guard against deflation in the American economy—a greater danger than anything a cheaper dollar could plausibly inflict.

The dollar's slide—and the corresponding appreciation of the euro and the yen—give greater cause for concern elsewhere. Deflationary pressures are severe in Japan and mounting in Europe. The fall in the dollar is equivalent to a tightening of their respective monetary policies. They need to move swiftly to offset, and more than offset, this inadvertent tightening of policy by lowering interest rates (in Europe's case) and by using unorthodox means to expand the money supply (in Japan's). Much to the cost of the countries concerned, moving swiftly has not been a great strength either of the European Central Bank or of the Bank of Japan.

Now that America is worrying about the dollar's decline, the administration's new treasury secretary, John Snow, is under attack (see article). Mr Snow must understand that being under fire for saying the wrong thing about the dollar is the larger part of his job. In framing his pronouncements on exchange rates, his best bet would be to establish a reputation for profundity by saying nothing, or by making whatever he does say unintelligible (Alan Greenspan, *passim*). Persuading the president to balance the fiscal books, at least in the long term, would also be a service.

The dollar's recent fall, welcome as it may be, could turn into a rout if the markets really take fright, and violent currency adjustments can do great harm. Unfortunately, overshooting is always a risk when economic imbalances get too big. But the fall in the dollar seen to date is welcome. When it comes to currencies, the prizes often go to the wimps.

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The European Union

Let the people vote

May 22nd 2003
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Europe's citizens should be allowed their say on the new constitution

Get article background

WHEN the idea of writing a formal constitution for the European Union was first mooted, its advocates said that the EU should be easier for its citizens to understand. They were right. The implicit constitution lurking beneath the Union's tiers of treaties and practices is impenetrable even to experts in the subject—and this mystery arouses suspicion. Another reason to write a proper constitution, governments acknowledged, was that the Union is widely regarded as democratically impaired. Decisions made at the centre are remote from citizens. Lines of accountability are stretched thin. A new constitution would address this directly, aiming both to strike a better democratic balance and to make the channels of accountability easier to understand. All this would bring the Union closer to its people.

On these grounds, *The Economist* warmly endorsed the idea of drafting a new constitution for the EU. We await June 20th with the keenest interest: that is when Valéry Giscard d'Estaing, representing the constitutional convention, will present a final proposal to Europe's leaders. Of course, whether the convention drafts a good constitution or a bad one remains to be seen. The signs so far are discouraging, though much could change before the debate concludes. However, regardless of what the convention proposes, and whatever constitutional design member-governments later adopt in the inter-governmental conference that will decide matters, one thing follows from the reasons for embarking on this exercise in the first place. The new constitution should be submitted to referendum in each of the member countries.

It may be that the new constitution will represent a bold new move in the direction of “ever closer union”, as espoused in one of the EU's earlier treaties. Perhaps, as we have urged, the constitution will explicitly reject that ideal, providing instead a stable settlement rooted in the principle of subsidiarity (the idea that decisions should be taken as closely as possible to the people they affect). Or it may be that the new constitution will do neither of those things, and merely condense and clarify the existing commitments, obscured as they are at present by the way the Union has evolved. As far as the need to establish legitimacy for the constitution is concerned, it makes no difference. So long as the idea is to say plainly what the Union is, what it intends to be, and how it will henceforth stand in relation to its citizens, this will be a hugely significant document—one that cries out for popular endorsement.

Referendums can have their drawbacks, but if any political decision lends itself to a vote of this kind it is a new (or newly clarified) constitutional settlement. Some governments are already committed to holding such a vote. Many others are thinking about it. In Britain—where, according to a recent poll, 84% of citizens would like the new constitution to be put to a referendum—the government has brusquely repudiated the idea. Given that the government has called 34 referendums (mostly about mayors) since 1997, it seems odd to draw the line at the biggest constitutional issue to have come before the country for decades.

“Those campaigning for a referendum might as well put away their placards and save their money, because we are not going to do it,” decreed Peter Hain, Britain's minister for Europe, representative at the convention and noted champion of democracy. So much for accountability. Mr Hain must be obliged to eat his words. Let the people vote.

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Civil wars

The poor man's curse

May 22nd 2003
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Some things the world can do to prevent wars

AP

CIVIL war, says the World Bank, is “development in reverse”. The world's poorest countries are disproportionately likely to be at war. Studies suggest that poverty and economic stagnation cause conflicts, and conflicts, of course, aggravate poverty, as the people fleeing the devastated Congolese town of Bunia this week can testify (see article).

Pessimists argue that little can be done. Immature societies, riven by tribal passions, are doomed to fight for years to come. Most rich countries were once poor and war-ravaged, but they eventually grew out of it. You can't hurry history, so why try? Optimists believe that quite a lot can be done. Given the scale of misery that civil wars cause, even a small reduction in their number would be a colossal blessing. So what might work?

The most reliable defence against war seems to be economic growth. Countries that are getting richer very rarely fall apart, so policies that promote growth also promote peace. Economists may differ as to what the best policies might be, but mostly agree about the worst ones. Hardly anyone favours rigged exchange rates, high inflation and unchecked corruption, which are common in countries that end up at war.

Nations with plentiful natural resources face extra risks. Rebellions are often fuelled by people's anger that their governments deny them a fair share of revenues from, say, the oil beneath their ancestral lands. Such grievances are often justified, but can be assuaged through greater openness in how petrodollars are spent. It might help if the World Bank, say, devised a standardised way of accounting for such revenues. In its absence, East Timor and São Tomé, two countries where oil has recently been found, went for advice to Angola, where the government is about as transparent as an oil slick.

More could be done to starve rebels of funds. Global efforts to curb the trade in “conflict diamonds” reduced the prices that guerrillas in Angola and Sierra Leone could charge for their stones, which may have contributed to the defeat of both groups. In January, a new certification process was launched to keep conflict diamonds out of reputable shops. If it works, something similar could be applied to timber, which fuels rebellions in Liberia and Cambodia.

Some rebels make a lot of money from kidnapping. Their earnings could be squeezed by banning ransom insurance, which feeds higher ransom demands. Some rebels occupy border zones and profit from smuggling everyday goods that are subject to high tariffs. This racket could be eliminated by slashing tariffs, which is a good idea anyway. Some rebels grow rich from the trade in illegal drugs. Legalising such drugs, besides dealing a massive blow to mafias in rich countries, would help bring peace to Colombia and Afghanistan.

Carrot and stick

Countries that make peace are usually rewarded with foreign aid. Unfortunately, this tends to arrive in a sudden wave, before the government has the capacity to absorb it. It then declines, as donors' expectations are disappointed. A convincing new study suggests that aid can do more good if it starts at modest levels and gradually increases, giving the wounded state time to recover and adjust.

Rich countries must also pay more attention to the sudden economic shocks to which poor countries are vulnerable. Sudden plunges in the price of coffee or cotton pluck fewer heartstrings than floods or earthquakes, but can be much more destabilising, and so make war more likely. Aid should take such shocks into account, and western policymakers should try to stop aggravating them by, for example, increasing domestic farm subsidies when prices fall.

Finally, rich countries must sometimes be prepared to kill. Voters are justifiably wary of distant entanglements, but a well-equipped force with a robust mandate can quickly smash the less-disciplined rebel groups, as Britain did in Sierra Leone. If France, and perhaps even overstretched Britain, were to send peacekeepers to Congo, the world should cheer.

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Zimbabwe

Good news only, from now on

May 22nd 2003
From The Economist print edition

The last foreign correspondent is kicked out of Harare

Get article background

AP

LAST week's illegal deportation of Andrew Meldrum, who reported from Zimbabwe for *The Economist* and the *Guardian*, sends that unfortunate country spiralling into ever grimmer depths. For a start, it demonstrates Robert Mugabe's complete disdain for due process. Zimbabwe joins other tyrannies where power is at the whim of the leader, unchecked by the rule of law. And now that the only remaining foreign correspondent has been evicted, the job of shedding light on what goes on will be left to local reporters, many of whom are brave but all of whom are vulnerable to the regime's brutality.

Mr Meldrum, who has been reporting Zimbabwean affairs in an exceptionally fair-minded way since Mr Mugabe came to power in 1980, has permanent resident status which guarantees him, according to a High Court ruling issued last year, the right to remain in the country. As he was being bundled out on May 16th, his lawyer presented the authorities with a new High Court order that declared his eviction illegal and demanded that it be stopped. Nevertheless, he was forced on to an Air Zimbabwe flight to London. “This is not the action of a government confident of its legitimacy,” shouted Mr Meldrum, as he was manhandled by Mr Mugabe's goons.

But even the goons now have doubts about their leader, some of them whispering to Mr Meldrum that they knew Mr Mugabe must go. His cruel ways, the crushing of the opposition, the fraudulence of the elections, may not offend them. But he has also reduced a country that once did well for itself to penury. Two out of three of Zimbabwe's 12m people are dependent on food aid; unemployment is around 70%; and the shelves are bare of everything that people need to survive.

How to hasten his departure or, more improbably, to reform his ways? The bleak truth is that there is not that much that can be done outside Africa itself. One minor suggestion: the West could extend its targeted sanctions, which freeze the assets of, and ban travel by, Mr Mugabe and his cronies, to the business associates who bankroll his regime. But since stiffer general sanctions would make the lot of ordinary people even more wretched than it already is, the West's most effective pressure is probably indirect: pressing Zimbabwe's neighbours, above all South Africa, to press Zimbabwe.

Quiet diplomacy, which is South Africa's way of dealing with its tragic and dangerous neighbour, can be a euphemism for doing damn all. Thabo Mbeki is now understood to be leaning less lightly on his fellow-president, even quietly calling on him to share power. Those who demand more robust persuasion—switching off the electricity supply, calling in bad debts—point out that there is no evidence of this softly-softly approach making an impact. But care is needed: Mr Mugabe's defiance has made him a bit of a hero in some African quarters—though not in his own country, where Mr Meldrum tells us that even his secret policemen are fed up with him.

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Argentina's new president

Out of Patagonia

May 22nd 2003
From The Economist print edition

Néstor Kirchner will have to turn his weakness into a strength

AP

WHAT is it about Argentina's presidency? On May 25th, Néstor Kirchner, the previously obscure Peronist governor of a Patagonian province, takes up that ill-starred job having won a mere 22% of the vote in an election last month. He was denied the popular mandate he so badly needs to govern a shattered country by the craven decision of his rival, Carlos Menem, himself a former president, to avoid overwhelming defeat by pulling out of a run-off ballot. Mr Kirchner duly, if in an unsatisfactorily hollow way, becomes the fifth man to hold the presidency since December 2001, when Fernando de la Rúa, a hapless Radical, resigned in the face of rioting protestors. All of this makes 15th-century Florentine politics seem rule-bound and orderly. In such unpromising circumstances, can Mr Kirchner do better than his predecessors?

The portents look gloomy. The outgoing president, Eduardo Duhalde, a Peronist political boss, began the job of rescuing Argentina from its financial collapse of 2001-02. But he put off many of the tough decisions needed to turn a cash-driven recovery into sustainable growth. And despite Argentina's default on $60 billion in bonds in 2001, Mr Duhalde issued (or announced) $27 billion in new debt, mainly to compensate banks for his mishandling of the currency's devaluation. Procrastination and the writing of IOUs cannot be options for Mr Kirchner. He faces difficult negotiations, not just with the bondholders but with the IMF. A temporary accord which rolled over repayments to the Fund runs out in August; Argentina needs a multi-year agreement in its place.

Even with a substantial debt write-off, renewing Argentina's access to foreign credit will demand fiscal austerity, raising the current target for the primary fiscal surplus (ie, before interest payments) from 2.5% of GDP to perhaps 4%. And there are other nettles Mr Duhalde preferred not to grasp, such as enabling privatised utility firms to increase their tariffs and letting banks seize the assets of debtors. All of this is doubly hard in a country where 59% are now poor.

What is worse, Mr Kirchner has little political capital to spend. He owes his election to Mr Duhalde's machine. He has little sway over the provincial governors, most of whom face elections in the next few months, as does half of the Congress. Mr Menem's cronies in the courts can be relied upon to make mischief. Mr Kirchner is in office—but he is not yet in power. It is enough to make anyone want to disappear to Patagonia.

Look harder, though, and you can see some reasons for hope. The humiliation of Mr Menem suggests that many voters want a new, more honest, politics. Much of the political class accepts that austerity is inevitable; Argentina avoided hyperinflation last year because Roberto Lavagna, Mr Duhalde's economy minister, persuaded the provinces' governors to cut spending. This mood gives Mr Kirchner an opportunity. His first job is to seek the consensus needed to write into law a far-reaching reform of provincial finances, pruning automatic revenue transfers from the centre. He will be helped in this by Mr Lavagna's decision to stay on.

Is Mr Kirchner up to the job? In his home province, his record was mixed. He co-existed harmoniously with private oil companies. But he engaged in the bad Argentine political habit of packing the province's courts. His bland personality reminds some Argentines of the indecisive Mr de la Rúa. Investors have been wary; they saw him as an economic interventionist of the centre-left, and preferred the jaded conservatism of Mr Menem. But as Lula has so far shown next-door in Brazil, ideology can count for less

than a commitment to responsible economic policies and the rule of law.

Peronism, that most protean of South American political movements, has survived Argentina's collapse. If it stands for anything, it is strong leadership. So it is ironic that it should now offer up such a weak figure. But Argentina's need is for a new kind of president, one who tries to build institutions rather than promising to fix everything himself. Therein lies an opportunity for Mr Kirchner, and for his country.

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Executive pay

Revolting shareholders

May 22nd 2003
From The Economist print edition

The trouble with the GlaxoSmithKline pay package was its reward for failure

Get article background

WHEN the public mood changes, the realisation can take time to sink in. Behaviour that was once acceptable can overnight come to be seen as outrageous. The board of GlaxoSmithKline, a big pharmaceutical company, found itself this week at the sharp end of such a mood change: its shareholders voted to reject the company's remuneration committee report, which would have endorsed a two-year notice period for Jean-Pierre Garnier, its chief executive; paid him $35m if he lost his job; and treated him and his wife as three years older than they actually are for the purpose of boosting their pensions. This is the first year that shareholders in Britain have had the right to vote on the compensation committee's report, and the vote is purely advisory, with no binding force. But it leaves the company, with which, of course, Mr Garnier has a contract, in a sort of legal limbo. More important, it leaves boardrooms everywhere in a tizz. Suddenly, the discontent of institutional investors with large executive pay packages and poor corporate performance has found an outlet.

GSK is in an odd position: the majority of its shareholders are in Europe but, as the company defensively pointed out, it earns 54% of its pharmaceutical revenues in the United States. Mr Garnier is based in Philadelphia: not surprisingly, he expects to be paid with American generosity. For all the talk of a global market for talent, chief executives in Britain still earn considerably less than their counterparts in the United States. But American institutional investors have also become much more critical of excessively generous compensation packages. This year, there have been more shareholder resolutions on pay, more widely supported, than ever before (see article).

Company bosses have been slow to understand the new mood of outrage among shareholders. Institutional investors have for years accepted that bosses paid themselves more or less whatever they liked. So it is uncomfortable to face criticism. But behind the criticism is a strong feeling that many chief executives are living according to quite a different set of rules from ordinary mortals. Although the value of most large companies has shrivelled, the pay of their bosses has continued to rise; the value of their pensions has not collapsed; and they have struck lavish deals to cushion their fall if they leave.

Pay, yes, but only for performance

Some of the aspects of Mr Garnier's package that most irritated the shareholders were ones that appeared to reward, not superior performance, but simply being there. Lots of bosses have such components in their pay. Sometimes, they take the form of “golden hellos”: large sums simply for turning up to work. Sometimes, such packages are really tax-efficient ways of making other payments, such as buying a company from its owner by paying him partly in lifelong free medical treatment. It is hardly surprising that such deals are protected in the event of dismissal. However, to improve openness and to avoid appearing to reward failure, companies should be prepared to pay the price of a little less tax efficiency.

Of course, companies may strike bargains with bosses they want to unload in order to persuade them to go quickly and without a court case. They sometimes strike such deals with other members of staff. But a generous advance promise to reward failure is no way to encourage success. Like the “guaranteed

bonus”, that boardroom contradiction, and the lifetime free dental treatment, it offers chief executives a one-way bet.

If the GSK vote makes companies cautious about such deals, that is welcome. The market for chief executives is deplorably imperfect. There is no rate for the job; positions are often discreetly trawled rather than openly advertised; and boardroom search committees rarely ask, “Could we get someone equally good even if we paid a bit less?” If the board now has to defend its compensation decisions publicly, it may be easier to say no. “We'd love to give you a golden parachute, old chap, but the shareholders would make a fuss.” More fuss, please, from shareholders. It's their company, after all.

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Letters

May 22nd 2003
From The Economist print edition

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Something in reserve

SIR – Your argument that tax relief should be extended to all savings is dangerous ("How's your pension doing?", May 10th). In economic conditions such as those afflicting much of the industrialised world at present, taxes on savings should rise to encourage consumer spending and so stimulate demand. Governments are stripped of an important tool of fiscal policy by blanket tax cuts on savings. This option is even more vital in states with a supernational currency or a currency controlled by another country's central bank.

Daniel Rothschild
Manchester

SIR – Good as your idea is to put the onus on the individual for providing for retirement, how would you persuade the millions who will most need it to save and learn how to invest while avoiding bad advice or fraud?

Herbert Eichner
Marbella, Spain

Long in office

SIR – As David Oddsson begins his fourth four-year term as Iceland's prime minister he may indeed serve 16 years, as did Germany's chancellor, Helmut Kohl ("Cod's own country", May 17th). But your claim that he will thus become western Europe's longest-serving head of government since 1945 is unfounded. Sweden's prime minister, Tage Erlander, ruled that social democratic Eldorado between 1946 and 1969.

Asgeir Sverrisson
Reykjavik

Lacking consensus

SIR – Your article on the failure of the "Washington consensus" in Latin America, like the consensus itself, misses a vital point: economic transformation is not purely an economic matter, it is also sociological ("Wanted: a new regional agenda for economic growth", April 26th).

The technocrats who administer economic reform have failed repeatedly to address the social changes needed to implement economic changes. Corruption, for example, is a sociological phenomenon reflecting a lack of respect for the law and institutions. Until the IMF and World Bank begin to recognise that "hearts and minds" campaigns must be waged and won in transformational economic and social "wars" these organisations will fail.

Julian Swearengin
Boston

SIR – What has been discovered in Mexico is that economic liberalisation and democratisation are necessary but not sufficient conditions for development. As you say, "second generation" reforms,

institution building and judicial reform are lacking. But these elements should be subsumed under the broader concept of the rule of law.

Implementation of the rule of law implies a realignment of the relationship between government and governed, and a reiteration of the rules of the game (laws and rights) and their implementation (the judiciary, law enforcement, citizens' attitudes). In much of Latin America the rule of law does not exist at the most basic level of property rights. Change is easy to propose but hard to do, which may be one of the reasons for a reluctance to face it head on, in the literature and in practice.

Timothy Heyman
Mexico City

Testing times for the euro

SIR – You suggest three new tests to be met before Britain's entry into the euro ("Britain and the euro", May 3rd). However, three other tests are essential for a currency union to work successfully. There must be a common culture and language to facilitate free movements of labour across borders; flexible wages to accommodate variations of labour supply; and a federal fiscal system to offset regional inequalities of growth.

America's has these. For Europe to come even close to meeting these tests would require political union. This is unpopular and not in our interests, as the past few months have shown. And no one can ignore the damage the euro has done already.

Theodore Roos
London

America's right

SIR – Before they became neo-conservatives, America's neo-cons were anti-communist left-wing intellectuals ("The shadow men", April 26th). When the American left radicalised in the 1960s, it alienated the anti-communists in academia. These academics were the Democratic Party's main source of intellectual rigour. After their departure, they were replaced by thoughtless utopians and special-interest groups. To this day the anti-communist left is virtually extinct in America.

The transformation of the anti-communist left to neo-conservativism is thus at the root of the Democratic Party's 30-year inability to gain support among America's working class, which remains fervently anti-communist and anti-socialist. Many of the second generation of neo-cons have followed a similar path; they began as liberals but came to reject the left's belief that moral good can be achieved only through socialistic policy. Many young liberals undergo transformation as students, when they see what the left has done to America's traditions of liberal learning. Many neo-cons are former liberals who have been "mugged by reality".

Jonathan Yaeger
Cincinnati

SIR – You state that neo-cons think of America in terms of a "unipolar world". While this may be true in military terms, it is not the case for world politics nor the global economy. For one thing, many of America's political challenges around the world require the assistance of other countries.

More importantly, America can ill afford to go it alone economically. For all of the neo-con's unipolar bluster, America will have to seek multilateral solutions to many of the political and economic challenges facing it worldwide to maintain peace abroad and prosperity at home.

Prescott Wurlitzer
Fox Point, Wisconsin

Inappropriate behaviourists

SIR – The behaviourist paradigm in economics, while important, must be applied with caution (Economics focus, May 10th). Much of the work done by behaviourists such as Daniel Kahneman and Amos Tversky emphasises the distinction between normative and positive behaviour (ie, how people should make

decisions versus how they actually do so). While it is useful for students to understand how and why individuals miscalculate risk and ignore opportunity cost, teachers of economics would be remiss if they failed to emphasise the ideas from neoclassical economics that lead to rational decision making.

Derek DeLia
New Brunswick, New Jersey

SIR – You say that Harvard University is thinking about offering an “alternative” introductory course in economics that is taught by a man who earned his tenured chair by “attempting to square a Marxian approach with Keynesian demand theory.” Is the Harvard physics department also thinking about offering an alternative introductory course taught by a man who earned his tenured chair by attempting to square the behaviour of phlogiston with the ether?

James Degan
New York

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About sponsorship

Civil wars

The global menace of local strife

May 22nd 2003 | BUNIA, CONGO
From The Economist print edition

AFP

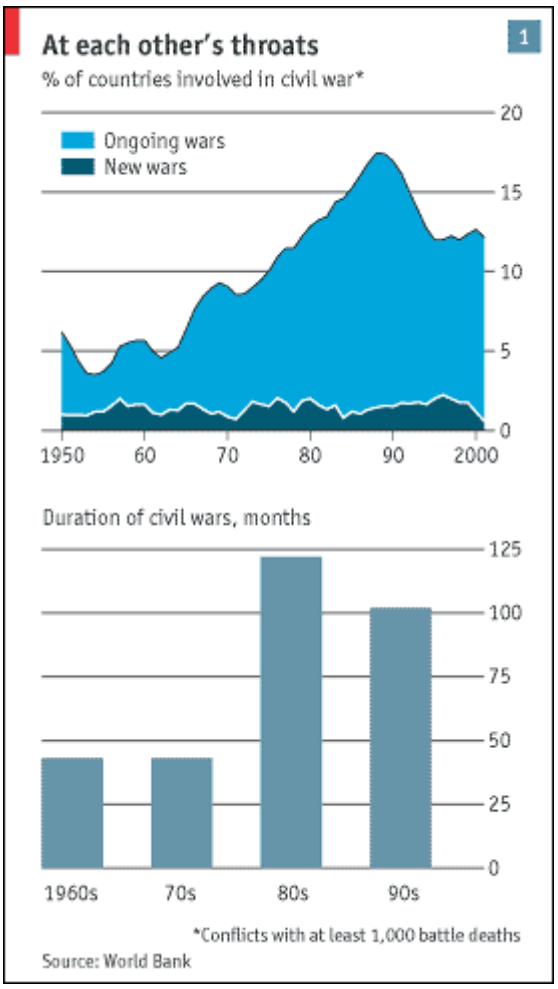
Almost all wars are now civil wars. Many of the causes are economic

IN A confetti of medicines, pens and second-hand shirts, armed looters rage through Bunia's main market-place. Startled, the local dogs stop feeding on the rotting human corpses scattered among the empty fruit and vegetable stalls. The mob, which is also looking for food, finds none, and moves on. The pack resumes feeding in quick, delicate bites.

Once a prosperous gold town, ringed by fertile green hills, Bunia, in eastern Congo, was ransacked and deserted last week. Where one gold-trader had his shop, only a gold-paint picture of a pair of scales remains. Every other stall has been gutted, too; boy warriors with AK-47s clamber in and out of jagged holes in once smoothly plastered walls.

The cyclone struck after the Ugandan army, a plunderous occupying force, withdrew. The two largest local tribes, the Hema and the Lendus, then began to fight for control. First, Lendu militiamen poured into town, killing Hemas and burning their houses. Days later, Hema warriors counter-attacked and chased the Lendus away. No one can say how many died, but the fighting seems to have put at least 250,000 people to flight.

The death toll since Congo's war began in 1998 is higher, at between 3.1m and 4.7m, than in any other ongoing war. But otherwise the conflict is typical of today's wars. The combatants are mostly irregular militias, their victims mostly unarmed, and the fighting has gone on for nearly five years. A century ago most conflicts were between nations, and 90% of casualties were soldiers; today almost all wars are civil, and 90% of the victims are civilians.



Civil wars are much more common than they were 40 years ago (see chart). This is mainly because, back then, most of the countries currently fighting were colonies, so powerful outside forces imposed stability. Counting only wars with more than 1,000 violent deaths, about one country in eight is embroiled in one. This proportion peaked around 1990, after the superpowers stopped bankrolling rebels who attacked each other's allies. But post-cold-war peacemaking seems to have fizzled, and civil wars are getting longer. An average conflict lasts eight years, more than twice the norm before 1980.

Why is this happening? Some blame tribalism: a pleasingly simple thesis that both seems to fit the facts, and gives outsiders an excuse for indifference and inaction. But the reality is more complex. Tribes often quarrel, but ethnic passions on their own are rarely enough to stoke a full-blown war. The Hema and the Lendus, for example, have been trying to wipe each other out only since Uganda started arming rival tribal militias in 1999, in the hope of controlling the mineral-rich region around Bunia. If tribalism is the problem, ethnically homogenous countries should be peaceful—but look at Somalia.

Or at Sudan, whose civil war is often seen as a simple conflict between Arab Muslims and black non-Muslims. The view from the battlefield is cloudier, however. Last year, your correspondent met David Matwok, a young militiaman in the pay of Sudan's Arab government, who was lying on his back on the savannah with both legs broken by bullets. Mr Matwok was a member of the Nuer tribe; so were the rebels who had shot him, during a pitched battle. The battlefield had seen Nuer fight Nuer before: among the still-bleeding corpses were scattered human vertebrae and clean-picked skulls, like golf balls on a vast green fairway. Every bone had once belonged to a Nuer.

And why were they fighting? According to the rebel commander, “Even where you are sitting, there is oil.” Money trumps kinship. Mr Matwok begged for water, but his fellow tribesmen told him they hoped wild animals would eat him.

All wars are different, of course. Each arises from a unique combination of causes, and each requires a different sort of solution. Nonetheless, by looking at what the most conflict-prone places have in common, it is possible to identify likely risk factors. This, in turn, might help to prevent wars in the future.

What causes wars?

A new study by Paul Collier of the World Bank and others, which examines the world's civil wars since 1960, concludes that although tribalism is often a factor, it is rarely the main one. Surprisingly, the authors found that societies composed of several different ethnic and religious groups were actually less likely to experience civil war than homogenous societies.

However, in multi-ethnic societies where one group forms an absolute majority, the risk of war is 50% higher than in societies where this is not the case. This is perhaps because minorities fear that even if the country is democratic, they will be permanently excluded from power.

The most striking common factor among war-prone countries is their poverty. Rich countries almost never suffer civil war, and middle-income countries rarely. But the poorest one-sixth of humanity endures four-fifths of the world's civil wars.

The best predictors of conflict are low average incomes, low growth, and a high dependence on exports of primary products such as oil or diamonds. The World Bank found that when income per person doubles, the risk of civil war halves, and that for each percentage point by which the growth rate rises, the risk of conflict falls by a point. An otherwise typical country whose exports of primary commodities account for 10% of GDP has an 11% chance of being at war. At 30% of GDP, the risk peaks at about one in three.

Why are poor, stagnant countries so vulnerable? Partly because it is easy to give a poor man a cause. But also, almost certainly, because poverty and low or negative growth are often symptoms of corrupt, incompetent government, which can provoke rebellion. They are also common in immature societies, whose people have not yet figured out how to live together.

Natural resources tend to aggravate these problems. When a state has oil, its leaders can grow rich without bothering to nurture other kinds of economic activity. Corrupt leaders often cement their support base by sharing the loot with their own ethnic group, which tends to anger all the other groups.

Most countries have what Mr Collier calls “ethnic romantics who dream of creating an ethnically ‘pure' political entity”. If oil is found beneath their home region, their calls for secession suddenly start to sound attractive to those who live there, and abhorrent to everyone else. Oil was one reason why Biafra tried to secede from Nigeria, and why the Nigerian government fought so hard to prevent it.

Secessionist leaders in Aceh, an oil-endowed part of Indonesia, told potential supporters that secession would make them as rich as the people of Brunei. This ten-fold exaggeration raised expectations that were impossible to meet, which may explain why the rebels went back to war despite a peace deal in December promising Aceh autonomy and 70% of the cash from its oil and gas.

Guns cost money

Laurent Kabila, the rebel who overthrew the dictator Mobutu Sese Seko, once boasted that all he needed to mount a revolution was $10,000 and a satellite telephone. He was exaggerating. Recruiting soldiers in Congo (which was then called Zaire) is cheap, because the country is so poor, but it is not that cheap. Guns have grown less costly since old Soviet armouries emptied on to the black market, but they are not free. In fact, Kabila had a budget in the millions, partly because he enjoyed the backing of a foreign power, Rwanda, and partly because he used his satphone to sell mineral rights he did not yet control to unscrupulous foreign firms.

Rebellions almost always start for political reasons. But since sustaining even the crudest guerrilla war requires cash, rebel leaders have to find ways of raising the stuff. Many, including most in Africa, receive money from neighbouring governments hostile to the one they are fighting. Some rebel groups are supported by an ethnic diaspora whose members, since they live abroad, do not have to endure the consequences of the wars they help fund.

In countries with abundant natural resources, however, rebels have less need to beg. Alluvial diamonds, the sort that can be plucked from riverbeds without sophisticated mining equipment, have financed rebel groups in Angola and Sierra Leone. Illegal logging, another low-tech business, fuels fighting in Liberia and Cambodia. In Congo, half a dozen national armies and countless rebel groups have fought over some

of the world's richest deposits of gold, cobalt, diamonds and coltan.

AFP

Drug money buys Colombia's rebels even bigger guns

In countries with high tariffs, rebels can make money by seizing a stretch of border and charging smugglers less than the government would. Afghan fighters, for example, have prospered from the protectionism of Afghanistan's neighbours. Rebel areas are also ideal for growing drugs. An estimated 95% of the world's opium comes from war-torn nations, and Colombia's rebels thrive on coca.

Rebels rarely pump oil. It requires capital, skills and technology, and the firms that have these things prefer to deal with legitimate governments. But rebels can still profit from oil, by extorting money from oil firms. One technique, popular in Colombia and Nigeria, is to kidnap their employees and demand ransoms. Another is to threaten to blow up pipelines. Firms usually pay up. During the 1990s, European companies handed over an estimated $1.2 billion to rebel extortionists, a sum far greater than official European aid to the governments of the countries in question. Ransom insurance, now available, has the effect of raising ransom demands, and so increases the profits to be made from violence.

From comrades-in-arms to Cosa Nostra

Rebellions rarely begin as criminal business ventures, but they often mutate into them. Their leaders can grow fabulously rich. By one estimate, Jonas Savimbi, the late Angolan guerrilla chief, amassed $4 billion from selling diamonds, ivory and anything else his men could steal. Besides paying for bullets, such profits give rebel commanders a powerful incentive to keep fighting. Says Mr Collier: “Asking a rebel leader to accept peace may be a little like asking a champion swimmer to empty the pool.” Savimbi only laid down his weapons for good when he was shot dead.

War creates a vicious circle. When rebel groups start to make money, they attract greedy leaders. At the same time, war makes it harder for peaceful people to earn a living. No one wants to build factories in war zones. People with portable skills flee, and those with money stash it offshore. Peasants find it hard to farm when rebels keep plundering their villages.

Poverty fosters war, and war impoverishes. In Congo, a combination of violence and official neglect has all but destroyed the country's roads, telephones and organs of government. Whole regions are cut off from the centre. Rubaruba Zabuloni, for example, has been fighting for nearly 40 years. A dwarfish 69-year-old with a crew-cut and a black fur hat, he leads a 7,000-man militia in the hills above Lake Tanganyika. In the 1960s, he fought with Che Guevara; in later years, the Soviet Union continued to send arms. He is unaware of the demise of either.

The big foreign armies involved in Congo's war have more or less made peace, and a new central government is gradually forming. But dozens of smaller, local conflicts continue to blaze. They are fought with low-tech weapons: machetes, bows and a few guns. An endless cycle of atrocities creates an endless cycle of grudges, which fuel more micro-wars. “When we kill a Rwandan,” said Mr Zabuloni's personal witchdoctor, “we fry up his penis and eat it. It makes you fearless. Would you like to try it?”

Being a rebel footsoldier is no way to make a fortune, but it may be better than the alternative, particularly if the alternative is to be a rebel footsoldier's victim. One of the gun-waving boys in Bunia put it pithily. Asked why he chose to take up arms, Singoma Mapisa fiddled shyly with his new Seiko watch—a happy acquisition on a Congolese soldier's pay of nothing—and replied: “The Lendus murdered my parents. How else could I survive?” He was later seen pilfering two Mickey Mouse satchels, which could prove useful if he ever goes to school.

A typical civil war leaves a country 15% poorer than it would otherwise have been, and with perhaps 30% more people living in absolute poverty. The damage persists long afterwards. Skills and capital continue to flee, because people do not trust the peace: half of newly peaceful countries revert to war within a decade.

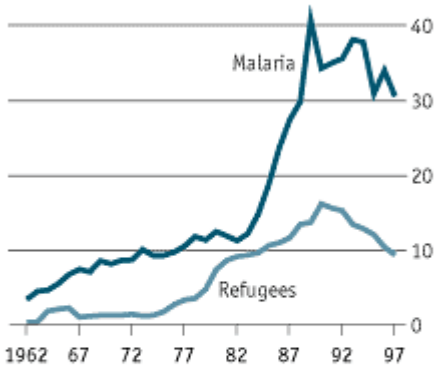
Infant mortality also remains high, not least because war nurtures disease. Refugees carry malaria from areas where the population is immune to a particular strain to areas where it is not. One study found that for each 1,000 refugees who flee from one tropical country to another, the host country suffers an extra 1,406 cases of malaria.

Rampaging armies are also efficient vectors for AIDS. Soldiers are more likely than civilians to be infected, and too often inclined to spread the virus forcibly. One study found that halving military manpower correlates with a one-quarter reduction in HIV among low-risk adults. Some researchers even blame war for the first spread of the AIDS pandemic, conjecturing that a small localised infection was carried far and wide through mass rape during the Ugandan civil war of the 1970s.

Besides scattering refugees and spreading disease, civil wars often disrupt trade across whole regions. Congo's war blocked the river along which the Central African Republic's trade used to flow, aggravating the CAR's economic malaise and perhaps contributing to a recent succession of coup attempts by unpaid soldiers. In all, having a neighbour at war reduces economic growth by about 0.5% each year.

War and plague ride together 2

Worldwide cases of malaria* and global refugee population, m



Prevalence of HIV in the armed forces†, %

Country	HIV prevalence	Country	HIV prevalence
Angola	40-60	Sierra Leone	61
Cambodia	7	Uganda	27
Congo	40-60		

*Not including China or India †Latest year available

Source: World Bank

Give peace a chance

Since countries prone to civil war are poor, stagnant places, anything that promotes growth ought to help. Governments in poor countries should strive to keep corruption, inflation and trade barriers low, while attempting to build better health, education and legal systems.

To guard against future insurgency, governments of newly peaceful countries often keep lavishing cash on the army. Military spending averages 4.5% of GDP in the first decade of peace, down from 5% during the war, but up from 2.8% before it. Such spending actually increases the risk of another war, because it wastes resources that could improve people's lives, and signals to rebels and people alike that the government is preparing for another war.

Spending on health and education, by contrast, seems to provide an immediate boost to the economy of a newly peaceful nation. This is surprising. The benefits of social spending usually take years to show up in the growth figures. But in countries emerging from war, a new school or clinic shows that the government is serious about peace, which buoys confidence and may encourage private investment.

Once war gathers pace, the vicious circle is hard to break. Intervention by proper armies with orders to shoot to kill can work: British troops helped save Sierra Leone, and the French legionnaires in Côte d'Ivoire have reduced the carnage there. The UN, whose peacekeepers are often ill-prepared for actual fighting, has a less impressive record. In Bunia last week, 700 Uruguayan peacekeepers were unable to prevent a massacre outside their barracks because their mandate was too feeble. The UN managed to broker a ceasefire on May 16th, but the only reason the fighting has stopped in Bunia is that one side has won. Out in the hills, the killing continues.

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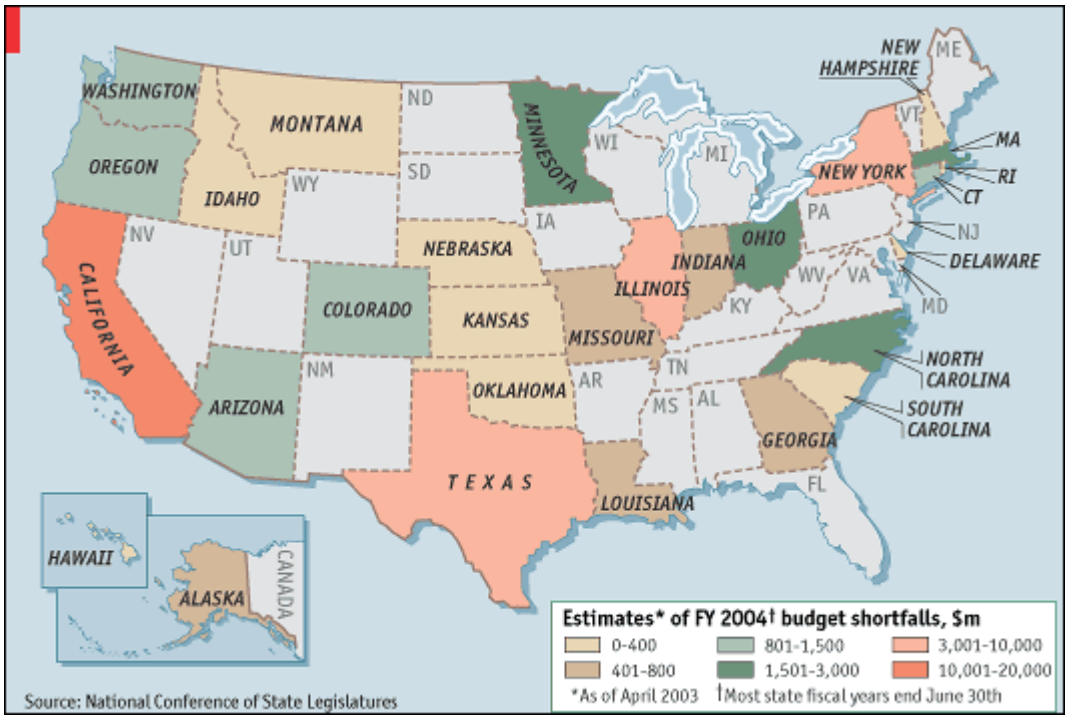
State finances

The head ignores the feet

May 22nd 2003 | WASHINGTON, DC
From The Economist print edition



The Bush administration seems indifferent to the budget crisis in the states. It may not be able to be so for long

IN STATE capitals across America, there is only one story in town: the disaster facing state budgets. According to the National Conference of State Legislatures, states face revenue shortfalls totalling $21.5 billion this fiscal year, which ends in June—23% more than they thought in November. Barely a day goes by but local newspapers report a new cut in services.

Back in Washington, the administration seems about as concerned as it would be by a budget deficit in France. In his original proposal for next year's federal budget, President Bush asked Congress for no extra aid to the states (though the deal struck in Congress this week would provide $20 billion, at the Senate's suggestion).

Worse, the administration has piled new obligations on state and local governments without providing the money for them. For example, this week's raising of the national terror alert to “orange” will require states to spend more on security. The administration also insists on election reform—a state responsibility—and costly “vulnerability assessments” of water systems, without providing the cash.

The biggest “unfunded mandate” is the No Child Left Behind Act of 2001. This requires all public schools to test students, in order to improve their education. In theory, the act fully finances the new tests. In practice, say local officials, implementing the act requires changes in the whole education system, not just adding a few extra tests. The cost, they say, is $35 billion a year more than the act provides for.

The mismatch between local alarm and federal insouciance is puzzling. On the face of it, you might have expected this White House to be sympathetic to state woes. Mr Bush was governor of Texas. His cabinet contains three—until this week, four—former governors (the attorney-general, the heads of Homeland Security and of Health and Human Services, and the outgoing head of the Environmental Protection

Agency). In general, Republicans believe in devolving responsibility to states, and Mr Bush is no exception. Two of his main initiatives, education reform and homeland security, rely heavily on the states, as do many lesser policies.

If all this were not enough, surely the sheer size of the problem should sway the White House. “The Incredible Hulk of budget deficits,” Minnesota's governor calls it. “This year's budget crisis will feel like ‘The Perfect Storm',” says the governor of Ohio. “The worst budget crisis among the states since world war two,” says Idaho's. And these are all Republicans.

Every state except Vermont requires itself to balance its books, and most are currently meeting—several in unprecedented emergency sessions—to reduce the shortfall. They have so far got it down from $26 billion at the start of the year to $21.5 billion. This has been painful; and more is needed. Almost half the school districts in Oregon are thinking of shortening the school year. Half the states are discussing cuts in money for schools and increases in tuition fees at state universities. About 1.7m people have lost, or stand to lose, state-subsidised medical insurance.

Even if the administration is blasé about these cuts, it might worry that belt-tightening will to some extent offset the hoped-for economic benefits of Mr Bush's tax cuts. Those cuts are intended to spur consumer spending and growth. But states are reducing public expenditure, throwing state employees out of work, and even (horror) raising taxes. Six have increased cigarette taxes, and 11 are discussing it. Three have raised sales taxes, and ten more are proposing to. Six are looking at higher personal-income or business taxes. Many governors are incensed that, at a time when the federal government is pushing through new tax cuts even at the price of higher budget deficits, it does nothing while states raise taxes and cut spending because they cannot go into the red.

Revenue shortfalls

As % of general fund budget*

Alaska	25.0
Arizona	25.0
New York	24.0
California	20.6
Oregon	17.0
Minnesota	15.5
Colorado	15.0
North Carolina	14.0
Illinois	13.6
Nebraska	13.6
Texas	12.0
Massachusetts	10.8

*Fiscal year 2004, mostly ending June; selected states

Source: National Conference of State Legislatures

So why the nonchalance? Can the White House go on looking so cool?

Part of the explanation for the administration's calm is that—as officials see it—the notion of a nationwide state budget crisis is overdone. In terms of national impact, the absolute size of the deficit is what matters, and half of the $21.5 billion shortfall is in two states, California and New York. New York has a famously dysfunctional budgeting process. It never seems to pass a budget on time, even in good years. And California, the biggest mess of all, is still suffering from the effects of a disastrous energy deregulation. There seems no compelling national reason for the federal government to sort out these muddles. Moreover, it is said, the states have brought their trouble on themselves. “They lived high on the hog in the 1990s,” says Trent Lott of Mississippi, “and now they're asking us to solve their problem?”

The 1990s saw a boom in spending as states expanded eligibility for programmes providing health insurance to the poor and to children. They failed to modernise tax systems developed for the manufacturing economy of the 1950s. Many depend to an unhealthy degree either on sales taxes, which tax only goods at a time when services have grown to almost 60% of the economy, or on capital-gains taxes, at a time when stockmarket gains have disappeared. These are not problems that can be solved by a bail-out.

Anyway, as White House supporters are not slow to explain, some states have coped. Florida's budget problems, for example, are less severe than most, even though it has been especially hard-hit by declining revenues from tourism.

Lastly, the administration is seeking to solve a specific problem in Medicaid, the health-insurance programme for the poor. Medicaid costs are exploding. Last year, for the first time, they exceeded the cost of Medicare, the federal programme for the old. As a share of states' spending, they have doubled since 1987.

Governors attribute the rise to the weak economy and soaring drug costs (see article on Maine's attempt to rein these in). But the Bush administration claims there is a bigger problem. The states and the federal government share the cost of Medicaid. This gives states an incentive to expand services and the number of people eligible for them because somebody else pays half the cost. Moreover, as Michael Greve of the American Enterprise Institute argues, the politics of Medicaid makes it especially hard to cut: not only are the beneficiaries mostly poor, but, because costs are shared, the federal government gets half the

benefit of every cut the state makes. The administration is therefore using the budget crisis to push states into accepting a reform, offering more money now in return for a new financing system.

That is why it is acting as it is. The question is how long it can hold the line. So far, it has buttressed its arguments with tough politicking. According to the *Wall Street Journal*, the governors of Colorado, Connecticut and Florida have linked up with Karl Rove, a White House adviser, to stymie attempts by the National Governors' Association to lobby for relief. When the NGA expressed regret about lack of help, Republicans threatened to withhold state dues. When the organisations representing county and city governments circulated a letter asking for aid, the NGA refused to sign it. “I was absolutely shocked,” the executive director of the US Conference of Mayors told the *Journal*.

This has worked so far, but the real test of the administration's resolve is still to come. Shortfalls in the 2004 fiscal year, which starts in July, could be as high as $80 billion. In 19 of the 50 states, the shortfall could reach 10% of spending. If these things happen, pressure for a bail-out could become intense. By then, says the president, tax cuts should have nursed the economy back to health, easing pressure on the states. So it has become a race against time. As with many other things, Mr Bush's policy towards the states depends on the condition of the economy.

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Kentucky's governorship

Pass the whiskey

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With a budget this bad, candidates and voters alike will need it

A DEMOCRAT in hot water for an extra-marital affair; a brief visit from a millionaire; rival candidates slogging it out with each other in the courts—stop us if you've heard it before. This was the run-up to the primary elections in Kentucky on May 20th that chose the candidates for the state's governorship, won (convincingly) on the Republican side by Congressman Ernie Fletcher and (less convincingly) for the Democrats by A.B. “Ben” Chandler, the state's attorney-general.

Mr Fletcher's win surprised few. A doctor and former air-force pilot, he was the favourite of Mitch McConnell, Kentucky's senior senator. Mr Fletcher's first choice for lieutenant-governor was an ex-aide of Mr McConnell's. But the aide had been working in Washington, DC. A rival sued, and Mr Fletcher was ordered by a judge to pick a new running-mate who met the state's residency requirement. Mr Fletcher remained unruffled—unlike one of his Republican rivals, who, when asked during a debate if he had threatened a reporter, vigorously replied that anyone he had threatened would already be dead.

If Mr Chandler thought he too would have an easy ride, he was wrong. He has a clean reputation as attorney-general, a popularly conservative view on state spending, and a former governor and senator, “Happy” Chandler, as his grandfather. He survived a challenge from Bruce Lunsford, a businessman who spent $8m of his own money on an unsuccessful bid for the Democratic nomination. But Mr Chandler, like so many Democrats in the south, is now in the wrong party. Although Kentucky has had only one Republican governor since 1947, five of its six present members of the House of Representatives in Washington, and both of its senators, are Republicans.

The performance of the departing Democratic governor, Paul Patton, did not help. Mr Patton presided over a booming economy and was re-elected easily in 1999. But in September 2002 a woman claimed that she had been having an affair with him, and that, after the affair ended, state inspectors had cracked down on the nursing home she owned. The mistress sued, the state ethics commission began an investigation of Mr Patton, and Kentucky's Democrats blushingly looked elsewhere.

The state's economy is in reasonably good shape. Its coal mines suffered when the electricity market weakened in 2000 and 2001, and its manufacturers saw their sales drop in 2002. But Kentuckians are less likely to be unemployed, and more likely to own their homes, than the average American (though they admittedly earn less). Betting at the Kentucky Derby on May 3rd was a record. The problem, as in so much of the country, lies with the state budget.

Spending has gone up, largely because of the rising costs of Medicaid and the state's prisons, and revenues have plummeted. Even though Governor Patton found some one-off sources of money, there is still a shortfall this year of around $82m. The governor tried, and failed, to raise the tobacco tax, the country's second-lowest, an unpopular move in a state so long associated with tobacco and alcohol. (His probable successor, Mr Fletcher, got money simultaneously from the cigarette-maker Philip Morris, from the company that sells Jack Daniel's and Southern Comfort whiskey—and from the American Medical Association.) Despite warnings of further revenue falls in 2004, both Mr Chandler and Mr Fletcher have danced around the budget problem, merely promising, perhaps unwisely, not to raise taxes.

Not that most Kentuckians seem to have noticed. Only about 18% of them bothered to vote. One small county saw only 40 Republicans come to the polls. If a sex scandal and looming budget cuts don't get Kentucky's attention, what will?

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The Crown Heights retrial

Twelve years on, the jury's still out

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From The Economist print edition

A hard crime for the law to handle

IN AUGUST 1991 a young rabbinical student, Yankel Rosenbaum, died of stab wounds suffered during a riot in Crown Heights, Brooklyn, after being pursued by a crowd of black men yelling, “Get the Jew.” Since then, the damage done by the case has continued to grow. When a jury at last returned a verdict on the evening of May 14th, almost 12 years later, it resolved none of the issues, except that the defendant had some, unclear, responsibility for a man whom he stabbed and who died.

From the beginning, the evidence of murder was quite strong. A young defendant, Lemrick Nelson, allegedly admitted stabbing Rosenbaum first to the police, then to his girlfriend. A knife that matched the wounds was allegedly found in his possession, stained, as was Mr Nelson's clothing, with blood that matched the victim's. With his dying breath, Rosenbaum identified Mr Nelson as his killer. The riot, though not the stabbing, was videotaped and the racial invectives clearly audible. Why, then, did a conviction not follow?

During the first trial in 1992, on a straight charge of murder, Mr Nelson's lawyer argued that his client was the victim of a police plot and misidentification. The jury agreed, celebrating with Mr Nelson after his acquittal. Retried for violating Rosenbaum's civil rights in 1997 (an established avenue for families of victims who are convinced that justice has not been done, though technically it has), he was found guilty. Last year, however, an appeals-court judge threw out the conviction, ruling that, even though the evidence was “overwhelming”, the trial judge had abused his authority by attempting to assemble a racially balanced jury.

This time round, Mr Nelson changed his defence. His lawyer claimed that Mr Nelson had indeed stabbed Rosenbaum, but the cause was his youth, and the madness of crowds, not religion, and thus there was no violation of Rosenbaum's civil rights.

For five days in early May, the jury heard evidence; for five days it deliberated. The issue of race hung over the courtroom. Eight of the jurors were black, two white, and two mixed-race Guyanese. When the judge instructed the jury to ignore the race, gender and faith of the defendant, Mr Nelson's lawyer objected.

Twice the jury said it could not reach a verdict; twice it was told to go on trying. It then found Mr Nelson guilty of a relatively minor charge: violating Rosenbaum's civil rights, but not directly causing his death. This appeared to be a compromise until three days later, on May 17th, when the *New York Times* quoted the jury foreman as saying that the jurors knew, from old news reports, that the Rosenbaums had sued the hospital that treated their son.

The doctors, it appeared, had not noticed the young man's large stab wound for some time; as a result, he bled to death internally. Though medical malpractice was never proven, the jurors concluded that the stabbing alone had not caused his death. Early in the trial, the issue of treatment had been ruled inadmissible, since the criminal is deemed responsible for the foreseeable medical consequences of his actions, including medical negligence. As always, the jury had been told to consider only the evidence heard in court. But it is hard for jurors to disregard what they already know, or think they know, and impossible to reprimand them if they fail to.

Mr Nelson will probably get a sentence of ten years; with time off for good behaviour and time already served, he may do only another ten months in jail. Meanwhile, blacks and Jews in Crown Heights have drawn closer, perhaps finding in each other a reassurance that no jury, no matter how balanced, can provide.

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Christine Todd Whitman

The end of the road

May 22nd 2003 | WASHINGTON, DC
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Or, you could say, the end of standing forlornly at the roadside

FOR two-and-a-half years, Christine Todd Whitman has been a dead woman walking in Washington. She is everything that most of her senior colleagues are not: a liberal Republican, a north-easterner, and a moderate environmentalist. On May 21st she belatedly woke up to the impossibility of her position and resigned as head of the Environmental Protection Agency.

Mrs Whitman was undermined from the first. In late February 2001, she told a group of G8 environmental ministers that the administration supported mandatory reduction of carbon-dioxide emissions, a central commitment of the Kyoto global-warming treaty. In a memo on March 6th she told George Bush that global warming was an important “credibility issue” for the United States, and that “we need to appear engaged”. A week later, Mr Bush announced that he was abandoning his support for the Kyoto Protocol, declaring it “fatally flawed”.

Reuters

Her boss wouldn't listen

This was just one of a long series of humiliations. Mrs Whitman tried to appeal to Mr Bush as a fellow former governor. She even gave him his beloved Scottish terrier, Barney. (Barney's mother, uncle and sister still live with the Whitmans in New Jersey.) Yet the White House repeatedly pushed her department to lighten the regulatory burden on industry. And the energy task-force chaired by Dick Cheney, the vice-president, focused single-mindedly on expanding the energy supply.

Mrs Whitman notched up a couple of important victories—ordering General Electric to clean up the Hudson river and strengthening Clintonian rules on diesel exhausts. But she lost far more often than she won—and spent too much of her time responding to “Bush cancels” headlines.

At one time, Mrs Whitman was regarded as the brightest female star in the Republican firmament. Her successful tenure as governor of New Jersey (she was elected in 1993 and re-elected in 1997) and her combination of conservative views on economics and liberal views on social issues meant that she was frequently talked about as a future senator, or even as a vice-president. Instead, she has spent the past two years trudging around toxic waste sites and recycling plants, while the environmental agenda has been set elsewhere.

Her marginalisation was only to be expected. Mr Bush is surrounded by former CEOs, many of them from the oil and gas industry, who regard environmentalism as namby-pamby nonsense. Washington think-tanks such as the Cato Institute and the Competitive Enterprise Institute regularly rubbish the Kyoto Protocol. Mr Bush got far more votes from the resource-rich states of the south and west than he did from Whitman country, the environmentally-sensitive states of the north-east.

Still, Mrs Whitman's resignation will not be without costs for the administration. The Republicans are weak among swing voters—particularly among suburban women who are worried that the Republicans are too close to big business. Mrs Whitman was an ideal missionary to this group. But how many moderate Republicans are willing to put up with a similar degree of humiliation?

This is the second high-profile resignation in a week. On May 19th Ari Fleischer, Mr Bush's press secretary, announced that he intends to resign in July to pursue a career in the private sector. But anybody who thinks that Mr Bush's administration is falling apart will be disappointed. With the election

campaign gearing up, the White House has told cabinet members and senior staff who are thinking of leaving to do so now. Otherwise, they will be expected to stay until after the election.

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Prescription drugs

The Maine chance

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A first hint that pills may get cheaper

IT'S official: Maine's controversial scheme to cut the price of prescription drugs can go ahead. The Supreme Court, ruling on May 19th, stopped short of deciding whether the scheme was legal, but lifted a lower-court injunction against it. In doing so, the court cheered the old and sick all around the country, heartened other states with the same idea, and infuriated Big Pharma, for which Lehman Brothers predicted net income losses of between 1.5% and 3.5% if discounting becomes general.

In recent times, drug prices have been rising by about 10% a year, three or four times the rate of inflation. This not only hurts the uninsured, but pummels states directly by increasing the cost of Medicaid, the federal-state programme that provides health care for the poor (and also pays for prescription drugs for the elderly, not covered under Medicare). Many states, struggling with falling revenues, have tried to restrict benefits and elegibility under Medicaid. New York and Connecticut are both suing drug firms over their prices and profits. Maine took a different tack.

Under its scheme, the state requires drug manufacturers who wish to sell their products in Maine to negotiate price rebates with the state authorities or, if they refuse, to jump through multiple hoops of state approval for every prescription in which their pills or potions are dispensed. Though this sounds somewhat socialist, and smacks of interference in interstate commerce, the justices overlooked that for the moment. In this distinctly federalist court, anything that enhances states' rights gets a sympathetic eye.

Other states have been watching eagerly. About half of them have been contemplating price-cutting, and 29 of them filed briefs with the court on Maine's behalf. Hawaii has a law ready to take effect; 18 legislatures have similar bills pending. Maine may still need to get approval from the federal Department of Health and Human Services, and may have to refine its scheme in various ways. But now the discount gate is at least part-open, it cannot be long before the rest of the country tries its best to gallop through it.

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Lexington

John Snow comes adrift

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Is the Treasury talking the dollar down?

GEORGE BUSH'S second treasury secretary was hired to sell economic policy, not to make it. After Paul O'Neill, his gaffe-prone predecessor, had alienated Congress, unnerved financial markets and annoyed many foreign governments, John Snow was sent in to repair the damage. With plenty of back-slapping bonhomie, the former railway boss was to be top salesman for Mr Bush's tax cut. His appointment marked a change of style, but not of substance. Until now.

In the past couple of weeks, Mr Snow seems to have recast America's dollar policy. In a series of comments, he has abandoned the earlier “strong dollar” stance: the notion, mouthed by treasury secretaries for the past eight years, that a strong dollar is in America's best interests. Beginning with a statement of the obvious—that a weaker dollar is good for American exports—Mr Snow went on to downplay the dollar's recent fall as a “fairly modest realignment of currencies”. (The greenback has fallen 21% against the euro and 14% against an overall basket of currencies during the past year.) Finally, Salesman Snow relabelled the product. America continues to believe in a strong dollar, he argued, but “strong” refers to the confidence that the dollar inspires in the public and its resistance to forgery. It has nothing to do with its value against other currencies.

Was this shift a gaffe of his own, an honest if misguided attempt by a straightforward chap to admit the obvious fact that the dollar is falling? Or was it part of a new Bush policy to talk the dollar down? The gaffe thesis is possible. The remarks took many top Treasury staff by surprise and, for all his silver-tongued salesmanship, Mr Snow has recently made comments on the tax cut that he later regretted. But, on balance, the error theory does not stand close scrutiny. Not only did Mr Snow take pains to point out that he had chosen his words carefully, but it seems unlikely that an intelligent man would make gaffe after gaffe on the same subject.

More probably, Mr Snow is signalling a shift in attitude, one perhaps not shared with bureaucrats within the Treasury, but cleared with the White House. At a minimum, the shift suggests that Team Bush has no problems with the weaker dollar. On the face of it, that should not be controversial. Until now, the dollar's decline has been an undoubted boon to America's economy, helping exporters without roiling financial markets. Rather than spouting some vacuous nostrum about a strong dollar, Mr Bush's CFO is simply telling the truth.

The risk is that Mr Snow has not just shifted towards benign neglect of the dollar, but hopes to do a bit of active (downward) prodding. Like many around the president, Mr Snow is a Main Street, not a Wall Street, man. His country-club pals are overwhelmingly industrialists, many of whom have long pushed for a weaker dollar.

For the politicos at the White House, too, a dollar that slides a bit more quickly has its attractions. Haunted by the memories of George Bush senior's defeat in the face of a jobless recovery, Karl Rove and his ilk are desperate to get the economy moving again and the unemployment numbers down. Despite Mr Snow's best efforts, the tax cut is proving trickier to sell than many imagined. And, despite the official White House rhetoric, it may not do all that much to boost the economy. Hence the attraction of a depreciating dollar. That will boost the economy quickly, and Team Bush will be able to claim credit for a stronger recovery during the elections next year.

Unfortunately, this is fraught with risks—risks that may be lost on both the political operatives and the industrialists who dominate the economic side of this administration. The politics of making a weak-dollar policy explicit could be disastrous internationally. America's economic fundamentals, particularly a gaping—and still rising—current-account deficit, suggest that the dollar has a lot further to fall, whether Washington likes it or not. By changing the rhetoric, the Bush team is now identified with this drop, even though most of it is inevitable. Foreigners will now see the dollar's depreciation as the Bush devaluation. And since a weaker dollar will cause headaches for those countries (particularly in Europe) whose currencies are strengthening, the Bush team has also invited more transatlantic political tension.

Blame it on inexperience

Irritating the French or Germans may not greatly bother this White House. But domestically, too, there are dangers in appearing to tout a weaker dollar. Nudging foreign-exchange markets is not like nudging freight trains. Currencies can move dramatically and easily overshoot levels that make economic sense. Large depreciations, once they start, can be difficult to stop. The brutal reality is that, with a current-account deficit of around $500 billion a year, America needs to continue to attract huge quantities of foreign money. The risk is that, if foreign investors believe the Bush team is intent on pushing the dollar down, they will become much less keen to hold American assets. That, in turn, could punish stock and bond markets. Another slump on Wall Street or a spike in mortgage rates would hurt the Rove battle plan for victory in 2004 far more than a boom from a weaker dollar would help it.

Given that the dollar was already falling, and is set to fall further, with no change in the official rhetoric, it seems odd to take these risks. Inexperience is probably the reason. Mr Snow stands at the front of an economic team that is even weaker than the crowd it replaced. The Treasury is full of vacancies; Mr Bush's budget director is leaving; the new head of the Council of Economic Advisors, Greg Mankiw, has not yet been confirmed by the Senate; and there is not one strong economist in the White House. No one, in other words, to tell Karl Rove that playing politics with the dollar is playing with fire.

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Canada's economy

Prairie madness and the strong loonie

May 22nd 2003 | TORONTO
From The Economist print edition

AP

The real threats to Canadian economic growth have little to do with BSE or SARS

Get article background

ONLY a few months ago, Canadian officials were crowing that their seemingly recession-proof economy was the best-performing in the G7, the rich world's top club. It still is. But its resilience is being sorely tested, and partly for some unexpected reasons. In the past two months Toronto, Canada's largest city, has been struck by the worst outbreak of SARS (severe acute respiratory syndrome) outside Asia. No sooner had this waned when on May 20th a cow on a farm in remote northern Alberta was diagnosed as suffering from bovine spongiform encephalopathy (BSE), or mad-cow disease. It is the first such case in Canada in a decade. But within hours the United States and four other countries had slapped a ban on imports of Canadian beef.

The impact was immediate. Many livestock auctions halted; shares of meat processors, fast-food chains and the two big Canadian railway companies all plummeted. Canada is the world's third-biggest beef exporter, after Australia and the United States. Beef is a C$4 billion ($3 billion) industry in Alberta, as synonymous with the province as oil and wheat.

The economic damage inflicted by SARS had been no less swift. The Greater Toronto Hotel Association estimates that its members have lost C$125m in cancellations since March. Average hotel occupancy slumped to 47% in April, from 68% a year earlier. Several big conventions were cancelled. SARS also prompted a slump in restaurant and retail sales in Toronto.

But for all the headlines they generate, the damage that BSE and SARS cause to Canada's economy is likely to be relatively small. Important as cows are to Alberta's ranchers and slaughterhouses, Canada's annual beef exports amount to less than three weeks of shipments to the United States from its car and truck plants. The health of those car plants are a much bigger headache for the economy.

The Royal Bank of Canada, a Toronto-based bank, says that SARS will inflict no more than a “temporary pinch”, perhaps shaving a quarter to a half percentage-point off the economy's growth in the second quarter. Dale Orr of Global Insights, an economics consultancy, has pared his growth forecast for this year from 3.4% to 2.6%, still the highest among the G7 economies. Rather than disease, the more sombre outlook reflects sputtering demand in the United States, which takes 85% of Canada's exports. Carlos Gomes, an economist at the Bank of Nova Scotia, another Toronto bank, expects that the car industry's output will shrink by 1-2% this year, after surging by 6% in 2002.

Another big drag on exports will be the Canadian dollar. The loonie (so named for the bird on the one-dollar coin) has soared from a record low of 62.1 American cents in January 2002 to over 74 cents this week, its highest level in six years. Behind that surge lies not just the greenback's weakness but a widening gap in interest rates. The Bank of Canada has raised its overnight rate five times in little over a year. The yield on ten-year government bonds has climbed to almost 5.2%, compared to 3.4% on similar American treasury bills.

The strong currency may boost productivity by making imported machinery and software cheaper. But exporters are squealing more loudly than importers are celebrating. Canadian Manufacturers and Exporters, a lobby group, complains that the loonie's jump threatens its members profit margins and will be “a significant drag on economic and employment growth this year.” The Bank of Canada is now unlikely to raise interest rates again until the American economy shows more convincing signs of recovery.

The fallout from the health scares is likely to be political as much as economic. They are sure to expose regional jealousies. The Liberal government in Ottawa has swung into action to help Toronto. Jean Chrétien, the prime minister, is just one of many politicians to invite the media to watch him wield chopsticks in a Chinese restaurant in the city in an effort to dispel public fears. A Liberal member of parliament has urged the government to cough up C$10m to sponsor a Rolling Stones concert in Toronto.

Just hours after the BSE case was confirmed, Lyle Vanclief, Canada's agriculture minister, tucked into a steak lunch in Edmonton. Mr Chrétien did the same in Ottawa. Alberta, with just two Liberal MPs compared to 98 from Ontario, will be watching carefully to see whether it gets the same attention as Toronto. Ralph Klein, the province's feisty conservative premier, immediately suggested that Ottawa pay for the Rolling Stones to visit Calgary. There's no moss on Mr Klein.

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About sponsorship

Brazil's trade

North, south or both

May 22nd 2003 | SÃO PAULO
From The Economist print edition

Crunch time for the FTAA

Get article background

ON TAKING office as Brazil's president in January, Luiz Inácio Lula da Silva declared relations with South America to be his top foreign-policy priority. Already he has hosted almost all of the South American leaders. But the visit that may matter most to Brazil's future is that of the United States' chief trade negotiator, Robert Zoellick, who is due on May 27th and 28th. He is coming to see whether fresh impetus can be given to the long-running talks for a 34-country Free-Trade Area of the Americas (FTAA), which are supposed to be completed by January 2005.

Once a fiery leftist, Lula denounced the FTAA during last year's election campaign as an American attempt at "annexation". Many Brazilians would agree with that. The foreign ministry, which leads Brazil's trade negotiations, has appointed a critic of the enterprise to its second most important job. Unlike Argentina, its main partner in the Mercosur trade block, Brazil has so far restricted its offer in the FTAA talks to trade in goods.

If Brazil is wary, the United States is partly to blame. So far, it has proposed to remove tariffs at different speeds on imports from four groups of countries, consigning Mercosur to the slowest group. Brazil's most competitive exports, especially agricultural goods, face most American protectionism. But the United States wants to delegate to the slow-moving Doha round of world trade talks the issues that for Brazil are most urgent, such as farm subsidies and anti-dumping duties.

The Doha talks were initially supposed to finish in 2005, in parallel with the FTAA. Partly because they are now stuck, few people think that the FTAA will start on schedule. Having concluded a free-trade deal with Chile, the United States is pushing ahead with separate, faster, talks with Central America.

Plenty of Brazilians would be happy to see the FTAA fail; electronics firms and makers of capital goods, for example, feel unready for American competition. But other Brazilians are alarmed by such a prospect. Marcos Jank, the president of the Institute for International Trade Negotiations, a new research body in São Paulo, worries that if the United States strikes bilateral deals elsewhere in South America, trade and investment could be diverted.

The gap between Brazil and the United States, co-chairs of the FTAA talks, remains wide. The Americans want Brazil to make new commitments on services, government procurement and intellectual property. Brazil wants the United States to give up its subsidy and anti-dumping weapons. But for all its coolness, Lula's government has not yet rejected the FTAA. "Our mood is not ideological," says Celso Amorim, the foreign minister. "It's a negotiating mood." Whether that is likely to produce any agreement should soon become clear. The period between Mr Zoellick's visit and the next FTAA ministerial meeting, in Miami in November, is "crucial" for the FTAA talks, says Donna Hrinak, the American ambassador to Brazil.

But Lula's focus is Mercosur. After growing swiftly for a decade, trade between the Mercosur countries collapsed along with Argentina's economy in 2001. Now it is recovering (see chart). Argentina's new president, Néstor Kirchner, is a fan of Mercosur. Both countries now have floating exchange-rate regimes; their currencies are even fortuitously aligned. That makes macroeconomic co-ordination more feasible. A single currency for Mercosur is an "objective", says Mr Amorim.

In the end, Brazil may find it hard to turn its back on a second-best deal with the United States. After all, to do so might distance it from other parts of South America. One way out, gaining Brazilian adherents, might be a less ambitious “four-plus-one” deal between the United States and Mercosur. In any event, the next few months may determine the shape of hemispheric trade for years to come.

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Argentina's new president

No great expectations

May 22nd 2003 | BUENOS AIRES
From The Economist print edition

Continuity amid hints of change

Get article background

MANY Argentines still have only a hazy conception of their new president. But they are quickly finding out more. So tight is the timetable of an improvised transition that just days after Carlos Menem's withdrawal scrapped a run-off ballot, Néstor Kirchner announced his cabinet. It revealed some overlap with the outgoing government of Eduardo Duhalde. But his team, and his pronouncements ahead of his inauguration on May 25th, also left some unanswered questions.

The 12 cabinet jobs were shared out in three equal parts between members of the outgoing government, independents, and trusted aides from Mr Kirchner's inner circle in Santa Cruz, his sparsely populated Patagonian province. As expected, Roberto Lavagna remains economy minister, but will also absorb the production ministry set up by Mr Duhalde. In an interesting gesture, Mr Kirchner has given the foreign ministry to Rafael Bielsa, a leftish jurist and anti-corruption campaigner.

Mr Lavagna's presence points to continuity in economic policy, even if some of Mr Kirchner's recent statements have rattled the financial markets. In his acceptance speech on May 14th he seemed to talk still in campaign idiom, vowing that “I will not be a prisoner of the big corporations.” He had earlier promised tighter regulation of privatised monopolies, and an expensive public-works programme. In the two days following his speech, the peso fell by 5% against the dollar, ending a month of steady currency appreciation, though it has since edged up again.

But Mr Kirchner, who has a reputation as a pragmatist, will lack both cash and room for heterodoxy. Mr Lavagna, a tough negotiator, has won the grudging respect of both investors and the IMF. Similarly, given his dependence on the old guard of his Peronist party, it is not clear how much scope Mr Kirchner will have to carry out a promised campaign against corruption.

The new president's first and biggest task will be to establish his authority over the country and the bitterly divided Peronists. With few followers of his own in Congress, Mr Kirchner will have to rely on Mr Duhalde's help to pass laws. But two things could help him. The economy is growing again; interest rates are falling, money is trickling back to Argentina and the prices of its farm exports are rising. And Argentines do not expect miracles of Mr Kirchner. A halfway competent and honest government would be enough.

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Cuba and the United States

Castro's grim phoney war

May 22nd 2003 | HAVANA
From The Economist print edition

America's reluctance to tighten its embargo is rare good news for Cubans

EPA

He still sees enemies all around

ORDINARY Cubans braced at the approach of their country's independence day on May 20th. Last month, Fidel Castro's communist government smashed the island's small but growing democracy movement. In response, the United States expelled 14 Cuban diplomats. It also signalled that it might use the anniversary to announce a tightening of the trade embargo against Cuba, unfastening the economic lifelines proffered under the Clinton administration. Cubans worried that George Bush might ban relatives in the United States from sending remittances, ground the 30 flights a week between the two countries and/or stop cash sales of the American food that improves meagre diets. In the event, in a short radio address beamed to the island, Mr Bush merely promised to foster democracy and human rights and wished Cubans godspeed in ridding themselves of Mr Castro.

That will prove difficult. After 43 years in power, Mr Castro shows no sign of retiring quietly. In last month's crackdown, the harshest since the 1960s, 75 activists were jailed. The government then executed by firing squad three men who had hijacked a Havana ferry in a failed bid to reach Florida. Mr Castro claims that he acted in self-defence: the party line, endlessly repeated by the state-run media, is that after Iraq Mr Bush plans “regime change” in Havana. Cubans watched the war through the lenses of Arab and European television cameras, courtesy of Mr. Castro's media monopoly. They were horrified.

Oswaldo Payá, who heads the Varela Project, a petition drive seeking democratic reform, and who is one of only a few dissident leaders still free, says that Mr Castro is simply manipulating Cubans' fear of war while trying to distract attention from economic problems. The government has ordered air-raid drills at primary schools, for example.

The official arguments have cut little ice abroad. Governments and many intellectuals normally sympathetic to Mr Castro have condemned him this time. Mr Bush's decision not to take further measures against the island owed much to divisions among Cuban exiles in Miami. But it has also denied

Mr Castro an opportunity in the propaganda war to shift the spotlight back to “American aggression”. That war is escalating: this week an American aircraft broadcast propaganda programmes, interrupting Cuban TV stations.

The new repression came as Cuba's economy once again faces hard times. The state-run sugar industry, the backbone of the countryside employing 400,000 workers, is near collapse. Last year, Mr Castro closed half of the island's 156 sugar mills, and ordered that other uses be found for 60% of land under sugar. Much has reverted to brush. Raw-sugar output this year, at about 2m tonnes, will be 45% down on 2002, and compares with a peak of 8.1m tonnes in 1989.

Sugar is in decline across the Caribbean, but in Cuba's communist economy there are few alternatives. Last year's closures left more than 100,000 workers jobless; the government now pays them to stay at home or to study in makeshift schools. For most, the only future is subsistence farming. Others are also affected. Big factories, such as one making cane cutters at Holguín, in eastern Cuba, and a tyre plant in Havana, have slashed output.

Mr Castro admitted in December that 2002 had been a “terrible year”: GDP grew by only 1.1% as tourism, now the island's main industry, fell off; the price of imported oil was high, and Cuba was hit by three hurricanes. All this has shown up in scarcer public transport and more frequent power cuts. Many Cubans say they find it harder than ever to make ends meet. Tourism has picked up this year, but that may not offset sugar's decline, officials say.

On top of this, the crackdown has poisoned ties with the European Union and Canada, which together provide more than 50% of the island's tourists, trade and foreign investment. Often at odds with the United States over Cuba, the EU and Canada are now furious at what they see as Mr Castro's betrayal of their more constructive approach. A plan for Cuba to join the EU's Cotonou trade pact has been dropped. To make the point, the EU mission in Havana invited American diplomats, those dissidents still free and the wives of those who are not, to a reception this month. Cuban officials walked out in protest at the presence of “enemies”. Nowadays, such talk convinces few.

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About sponsorship

Media freedom in Venezuela

Stoning the messenger

May 22nd 2003 | CARACAS
From The Economist print edition

Seeking censorship by other means

NO LOVE is lost between Venezuela's populist president, Hugo Chávez, and the country's privately owned media. They call him a dictator, and worse; he accuses them of a slow-motion “coup”. He has a point. The main television stations, especially, act as a propaganda arm for the opposition, and their owners have conspired with opposition politicians and generals. And Mr Chávez is right to claim that the media are free of government censorship.

But they face other threats. According to a new report by Human Rights Watch, in the 13 months to February 2003, there were at least 130 physical attacks on journalists in Venezuela. Most of the victims were from opposition media; their assailants were government supporters. The government condemns the attacks, but has done nothing to stop them.

Instead, the government is threatening to withdraw the licences of television stations for alleged breaches of regulations. Meanwhile, congress is close to approving a law that would grant the broadcasting commission (in practice a branch of the government, says Human Rights Watch) wide powers to fine and shut down radio and televisions stations. New rules, aimed ostensibly at protecting children, would prevent broadcasters from transmitting all but the blandest news and commentary, especially between 6am and 8pm. That looks like a formula for media self-censorship without tarnishing the government's claim to uphold media freedom.

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Correction

May 22nd 2003

In our edition of April 19th ("Chávez rides high, for now"), we said that 19 opposition supporters were killed during a demonstration in Venezuela in April 2002. In fact, 11 of the dead were supporters of President Chávez.

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Japan

Set our gizmos free

May 22nd 2003 | TOKYO
From The Economist print edition

Can their love of gadgets persuade the Japanese to liberate their economy?

AT FIRST, his message sounds familiar. Nobuteru Ishihara starts to describe some of the rules that Japan has relaxed during his two years as deregulation minister in Junichiro Koizumi's cabinet. Since Japan's achievement lists are always dwarved by what is yet to be done, the listener could be forgiven for being underwhelmed. But Mr Ishihara, a former journalist (and the son of Tokyo's outspoken mayor, Shintaro Ishihara), imparts a clever spin. As he lists each example, the minister stops in each case to marvel at how the previous rules were allowing Japanese technology to go to waste.

Mr Ishihara's favourite example is the spread of a smart card that deducts the fares of railway passengers as they pass through ticket-gates without their needing to insert the card physically into any device. These are now being adapted to many other uses. The regulation that once made them impractical was exactly the sort of outdated rule that infuriates reformists. If railways wanted to use the technology, they had to register every single railway station as a radio-broadcasting station. To Mr Ishihara, the inane thing about this rule was that “90% of the technology is Japanese”. Commuters in Hong Kong, Singapore and elsewhere had been using the passes for years. Japan had been denying itself a potentially huge market for its own companies' technology.

Not all of Japan's regulatory problems fit this pattern. But many do. When Mr Ishihara visited Singapore's massive container port, he was struck not only by its efficiency but by the Japanese technology that enabled it to operate with so few people. Last month, Japan's government granted a port in Kita-Kyushu special permission to operate around the clock. It now makes economic sense for the port to overhaul its technology. PSA, a Singapore company, will be the lead investor, but much of the technology will be supplied by Japanese firms. Mr Ishihara is also keen on the tiny chips that hold far more information than bar codes and can be attached to products in the retail pipeline. After a few rules changes, he says, a huge new market in these is beginning to evolve—in this case, exploiting Japanese technology at home without waiting for other countries to do it first.

Examples such as these give Mr Ishihara a powerful selling point for deregulation, which is often portrayed in Japan as a “foreign” idea. Western—especially American—advocacy of Japanese deregulation has strengthened the idea that deregulation is part and parcel of Japan's need to give up its own ways for foreign ones. Voters who might otherwise welcome reform in health care, farming, construction, work practices and countless other aspects of Japanese life are less keen on changes that look invented

abroad.

The promotion of technology, by contrast, is definitely an authentic Japanese value. Voters are happy to agree that speed counts in high-tech industries. One way Japan acquired its technological prowess was by letting its companies exploit a captive domestic market of gadget-crazy consumers and then rapidly develop better and cheaper models to export. To a Japanese technophile schooled in such thinking, the idea of passing up a domestic market for smart cards because it takes time to change a silly regulation seems perverse.

Of course, an over-emphasis on technology holds its dangers. Many things Japan needs to deregulate have little to do with high-tech, not least the tangled web of rules that bind the economy as a whole. A poorly regulated banking system, twisted tax rules, powerful government-backed companies and a host of other practices conspire to make it harder for dynamic new companies and sectors to thrive. Yoshihiko Miyauchi, who runs a leasing company and heads a panel of private businesspeople advising Mr Koizumi on deregulation, argues that many previous deregulation drives have foundered for failing to cut this Gordian knot.

Over-emphasising technology under-emphasises the many other good reasons to deregulate. Less red tape would help consumers and savers—and Japan has plenty of both. For now, however, Mr Ishihara's emphasis on high-tech may help him win converts for deregulation. The next rule he wants to axe is one requiring those fare-paying smart cards to carry a 250-character warning. Without the requirement for the warning, he says, firms could fit the cards into wristwatches. And what self-respecting Japanese commuter could resist that?

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India

Goodbye to all VAT

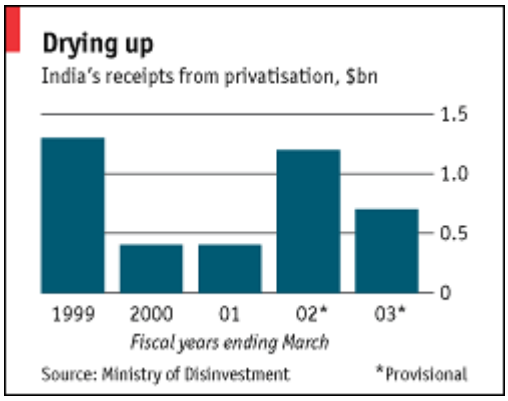
May 22nd 2003 | DELHI
From The Economist print edition

Once again, reform in India becomes a casualty of politics

JUNE 1st ought to have marked a milestone in the Indian government's efforts to boost the competitiveness of industry and curb its swelling budget deficit, with the introduction of a nationwide, harmonised, value-added tax (VAT), long called for by domestic and foreign experts alike in view of the distortions involved in India's present labyrinth of taxes.

Last week, however, and not for the first time, India's finance minister, Jaswant Singh, backtracked, this time in the face of nationwide protests by shop-owners, which were particularly effective in the capital, Delhi. Previous deadlines, from 2001 to April 1st of this year had already been missed. And Mr Singh's ministry is now talking vaguely about preparing a “new road map”.

The odd thing is that, for the first time, 16 states, accounting for 75% of the current $18 billion in annual VAT revenue, were almost ready to go ahead. Then politics intervened. Delhi is one of three key states (along with Rajasthan and Madhya Pradesh) due to hold elections by November, and traders are an important fund-raising lobby and vote bank, especially for the ruling Bharatiya Janata Party (BJP). Delhi is a trading rather than manufacturing centre and traders, unlike manufacturers, basically see the new VAT as an expensive hassle that will curb tax evasion. Delhi's economy, and its traders' political influence, spills over into surrounding states such as Rajasthan, Punjab and Uttar Pradesh, so it is no surprise that these states helped Madan Lal Khurana, Delhi's BJP president and the traders' champion, persuade Mr Singh to forgo his reformist credentials and apply the brakes.



Under India's federal structure, sales tax is mainly a matter for the states, with the central government playing a co-ordinating role. Efforts to boost manufacturing competitiveness by simplifying India's state-level system of different sales taxes began in the mid-1990s and gathered pace about four years ago with plans for a 12.5% state-level VAT system. This would run alongside an existing central-government form of VAT. Later, when plans for a new services tax have been implemented, a more comprehensive VAT might emerge. Even the current proposals would, says Jairam Ramesh, a Congress Party policy secretary and former finance-ministry adviser, remove cascading taxes and “help to build an Indian common market”.

Both the central and state governments have wanted to introduce the new VAT across the country on a single date in order to avoid confusion and reduce the risk of tax fraud between traders in different states. But the Finance Ministry is now wondering whether the new “road map” should plan implementation with just the bigger states in each region, irrespective of whether smaller ones are ready. Even then, Delhi and its neighbours would inevitably have to be included, so nothing is likely to happen till after the coming state elections. From the tax point of view, the next most convenient date would be June next year, when the trading cycle falls off ahead of the annual monsoon. But by that time India's general election, due between October and November next year, will give the traders' lobby another platform for protest.

VAT is not the only casualty of the elections. Privatisation sales of public-sector businesses such as Nalco, an aluminium company, to new private-sector owners are slowing down because of opposition from vested interests, though stockmarket flotations that do not change management control are going ahead. The next casualty might be HPCL, a refinery and petrol-station company, which the petroleum ministry

does not want to lose to the private sector. Nalco's privatisation was upset after violent protests stopped potential bidders visiting the company's plants, and there is a risk of similar protests that might deter foreign bidders at HPCL. May 21st saw country-wide strikes against privatisation, especially in the financial sector.

Mr Singh had to withdraw cuts in fertiliser subsidies within days of announcing them in his budget at the end of February; telephone-price increases were trimmed back earlier this month; and relaxation of the limits on foreign direct investment has been delayed. Taken with the VAT debacle, the message is clear. Do not expect any significant liberalisation that challenges India's politically influential vested interests until after the elections—which means that, barring a crisis, little might happen till early 2005.

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Indonesia

No early victory

May 22nd 2003 | LHOKSEUMAWE
From The Economist print edition

Indonesia faces a long and bloody war against Aceh's separatists

Get article background

WHEN, on May 19th, Indonesia launched its largest military operation since invading East Timor in 1975, it could not have been with greater fanfare. Highly visible paratroop drops, amphibious landings and bombing runs left the separatists of the Free Aceh Movement (known by its Indonesian initials, GAM) in no doubt as to the seriousness of Jakarta's determination to crush them. The flaunting of military power appeared to come with a new theory about how it should be applied. In contrast with previous campaigns in this resource-rich province on the northern tip of Sumatra, commanders said, civilians would be protected, media coverage would be encouraged and any soldiers who violated human rights would be shot in the head.

In other words a combination of raw power and sensitivity is supposed to succeed where all other approaches have failed since GAM's insurgency began in 1976. But it took less than 72 hours for the army's new "humanitarian" approach to fall apart. The likely prospect now is a protracted and messy guerrilla conflict. That is because, by May 21st, it was clear that GAM's fighters were not going to play by the rules Jakarta wanted. They did not intend to engage in crisp, clean clashes, confined to the combatants. And nor did all of the Indonesian forces.

Within two days almost 200 schools had been razed. Each side blamed the other, though the evidence suggests that the rebels rather than the government were mainly responsible for the mass arson. Their use of such tactics is understandable, if not condonable. The rebels have only 5,000 lightly armed fighters to pit against the government's 45,000 troops and paramilitary police, bristling with all the firepower an underfunded military can afford. A five-month ceasefire collapsed on May 18th, following the failure of last-ditch negotiations in Tokyo. After Jakarta's declaration of martial law in the province, the rebels could not have been expected meekly to lay down their weapons and surrender.

Rebel leaders now say that they want to prolong the conflict as long as possible, if their political demand for an independent state is not met, in the hope that frustration will set in amongst the Indonesian forces. This, it is hoped, will create a vicious circle (for Jakarta) of increasing desperation, human-rights violations and insurmountable international opprobrium. This part of GAM's plan appeared to be working well by mid-week. Or perhaps the troops stationed near the town of Bireuen had not heard the "respect the civilians" lecture. For in a dawn raid on four neighbouring villages they are believed to have killed 18 civilians, at least two of whom were young children.

AP

Back to battle

No explanation was given to the villagers, except that the operation was said to be part of the wider effort to crush GAM. No apology was given and no soldiers were shot in the head. "We face difficulties in distinguishing between rebels and civilians," said an officer. Shortly afterwards the regional military commander, who under martial law is the new provincial administrator, started imposing restrictions on the media. All reporters must now have special identity cards so they can be more closely monitored. And no one is allowed to quote GAM spokesmen lest

their “lies” cause confusion.

The United States, which was an observer at the Tokyo talks, has hinted strongly that the government in Jakarta could have done much more to avert war and has really been itching for a fight for at least the past six weeks. The diplomats of other countries concur. The conclusion most foreign analysts are drawing now is that the armed forces are deceiving themselves if they think they can defeat GAM at all, let alone within the six months promised earlier this month. Some members of the armed forces appear to agree. A military spokesman said ruefully, “This war definitely can't be won in weeks like the United States did in Iraq.”

Indonesia has tried to suppress the opposition in Aceh many times before, both under the former dictator Suharto and his successors. Six months seems no time at all in the context of a separatist rebellion that has been going on for 27 years, during which more than 10,000 people have died as a result of the fighting. No one is speculating when martial law will be lifted. The resumption of peace, let alone a permanent settlement, look like distant dreams. After a five-month hiatus it is back to killing as usual in Aceh.

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Indonesia

The girl who has a nation in a whirl

May 22nd 2003 | JAKARTA
From The Economist print edition

She starts a debate about “corruption”

AP

Public dancer

EVERYONE agrees that she is a marvellous dancer. Inul Daratista gyrates her hips and legs with increasing speed until her body becomes a blur of movement that sends her fans into raptures. She sings too. But not everyone is a fan. Indonesia is a Muslim country, generally tolerant, but its religious leaders say there are limits. The Ulemas Council has issued an edict against 24-year-old Miss Inul claiming that her dancing, which she calls “drilling”, is pornographic and is corrupting the nation's values.

Some legislators have considered summoning her to parliament to be questioned, but risk being accused of using their status to get a close view of the sinuous Miss Inul. Rhoma Irama, who calls himself the king of *dangdut*, a protest music popular in Indonesia, has sided with the priests in condemning Miss Inul. But perhaps he is jealous.

The reality is that Miss Inul, from east Java, is too popular, especially among the young, for the authorities to ban her. She is a sell-out at concerts and gets big audiences on television. On radio and television talk-shows she generates even more argument than the government's war against the Aceh separatists. Feminists, sociologists and theologians all have something to say. Newspapers have printed many yards of comment about her.

It may be that politicians with an eye on next year's elections will seek her support as a possible vote-winner. Abdurrahman Wahid, a former president of Indonesia with strongly held Islamic views, has dissented from those who want her dancing banned. Freedom of expression is what is important, he says. Miss Inul is no doubt grateful. It is a shame that Mr Wahid is almost blind.

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Afghanistan

Taking on the warlords

May 22nd 2003 | KABUL
From The Economist print edition

A rare victory for Afghanistan's put-upon president

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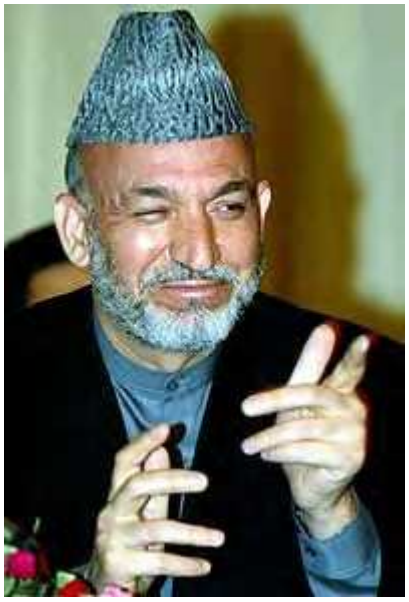
Reuters



Karzai faces them down

IT WAS an act of brinkmanship not often associated with the usually passive Hamid Karzai, Afghanistan's president. First he called the governors of a dozen border provinces to Kabul for a public dressing down, then he threatened to resign and call a new *loya jirga*, or grand council, to appoint a replacement if they did not agree to send the customs revenues they have been holding back to Kabul. Amazingly, all 12 duly came to town—in an oddly feudal convoy of gleaming jeeps with blacked-out windows—embraced Mr Karzai and, on May 20th, signed the document he put before them.

Good news at last for Mr Karzai. But then the governors had little to lose. Mr Karzai has no power to enforce the agreement, let alone to collect back taxes, or even to work out how much is actually being raked in at remote border posts by often corrupt officials. Mr Karzai said that the customs money would help boost central-government revenues from a pathetic $80m last year (excluding foreign aid) to $600m next year. Not likely, say observers close to the finance ministry. Several of the governors, notably Ismail Khan in the west and Abdul Rashid Dostum in the north, will still have the power to skim off what they see fit, albeit a bit less than before. After all, they need the money, not least in order to pay for their extensive private armies. Mr Khan's alone is tens of thousands strong, far outnumbering on its own the national army that Mr Karzai is trying to build. One estimate is that he could make as much as $300m a year from customs levies at the Afghan-Iran border.

Mr Karzai's posturing may have been directed at America as much as at his own countrymen. Some in his administration are worried about mixed signals they are receiving from Washington and the decline in American public attention following the war in Iraq. That was attested to by CNN closing down its Afghanistan operation this week. This was poor timing, some might say, given the growing instability in the south of the country.

United Nations staff and workers for aid agencies have been mostly forbidden to travel in those arid parts since the brutal execution of an International Red Cross engineer earlier this month by neo-Taliban fighters. At least 30 Afghan soldiers have died in clashes with similar forces in recent weeks. “It looks like 1992 all over again,” says a depressed UN old hand, referring to the warlordism of the period that followed the Soviet withdrawal from Afghanistan, which in turn led to the rise of the Taliban, who were on the whole welcomed because they promised stability.

Unverified reports have it that fighting has broken out this week in the remote central province of Uruzgan, the home range of the former Taliban leadership. And in the northern city of Mazar-i-Sharif 17 soldiers have been killed this week in fighting between Mr Dostum's men and those of Ustad Atta Mohammad, a rival warlord. Meanwhile, with the Taliban and their proscription of opium-growing gone, the drug trade is booming. An international conference in Paris this week heard that more than 3m people in Afghanistan now live off poppy cultivation.

Any bounce in popularity Mr Karzai might have expected to receive from swelling the government coffers, at least a little, was undermined by a shooting incident in Kabul on May 21st. American soldiers manning the barricade at the United States embassy shot dead four Afghan government soldiers and wounded

four others. The Afghans were apparently unloading weapons for a nearby intelligence depot when they were gunned down. An investigation is under way. Whatever the findings, the verdict in the southern provinces is likely to be unforgiving. In the local parlance the Americans are known as dogs and Mr Karzai is called a dog-washer.

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About sponsorship

China

Confucius and the party line

May 22nd 2003 | BEIJING
From The Economist print edition

The aim is to be moderately well-off

Get article background

THE fashionable new slogan in China is *xiaokang shehui*, or “moderately well-off society”. Well, it is not that new. The *xiaokang* concept dates back at least 2,500 years to Confucius, and possibly earlier, but has been given new life by the Communist Party. It denotes a middle-class level of prosperity at which basic needs are comfortably met, with a bit to spare besides. The slogan is being pressed into political service by a regime that needs desperately to convince its people that it cares about their welfare. The phrase is repeated constantly by leaders at all levels of the party, and celebrated by the *People's Daily* and other government newspapers.

EPA

A bit of luxury, but not too much

The party's previous attempt at governance by slogan was the poorly received “Three Represents” campaign. Far from winning support for the regime, its convoluted theoretical rhetoric only convinced people that party leaders were out of touch with their everyday concerns. The *xiaokang* campaign is clearly more politically marketable. In the early 1990s, when the beginnings of market reform allowed some urban Chinese to start having middle-class dreams, the phrase was occasionally used in consumer advertising with some degree of success.

John Schrecker, professor of Chinese history at Brandeis University in Massachusetts, says that the party would be aware of the slogan's ancient origin, and its use “suggests some sense of retreat from the utopian goals of Maoism”. Tang Jun, of the Chinese Academy of Social Sciences in Beijing, notes that in the 1920s and 1930s China's early communist leaders referred often to another Confucian concept, *datong*, or “great community”, a blissful society without private property, social groupings, crime, selfishness or war.

The appeal of *datong* to idealistic communists is obvious; so too is the need for today's pragmatic, and market-minded, leaders to find a more realistic goal. Yet Mr Tang is worried that the *xiaokang* campaign could further aggravate the divide now emerging between China's haves and its have-nots. “People who have done well under the reforms will like it, but laid-off workers and struggling peasants cannot see how they will ever reach a *xiaokang* lifestyle,” says Mr Tang.

If China's leaders have been reading their Confucius they are likely to be anxious about the possible failure of their new campaign. In “The Book of Rites” he wrote that Chinese kings who led their people to a *xiaokang* lifestyle were pillars of courtesy, sincerity, justice and virtue. But, the sage continued, “all rulers who did not follow their course lost power and position, and all regarded them as pests.”

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The return of al-Qaeda?

The undead

May 22nd 2003
From The Economist print edition

What the bombings and scares in Africa and the Gulf reveal about the state and intentions of al-Qaeda

Get article background

A FEW weeks ago, Colin Powell, America's secretary of state, hailed the progress of the “war on terrorism”. His counter-terrorism chief claimed that the terrorists were “on the run”. After the latest bombings, in Riyadh on May 12th and in Casablanca on May 16th, al-Qaeda is said to be back with a vengeance. Both these views—the premature reports of al-Qaeda's demise, and the notion of its resurgence—mistake the nature of the beast.

This week was dominated by the fear of terrorism. On May 20th, America raised its terror alert to the second-highest level. American, British and German embassies and missions in Saudi Arabia were closed to the public. Britain gave warning of a terrorist threat right across East Africa; other governments followed suit. British-registered flights to and from Kenya were grounded. A taped message, perhaps bearing the voice of Ayman al-Zawahiri, Osama bin Laden's right-hand man, called for attacks on the embassies and interests of America, Britain, Australia and Norway, and denounced Arab states that had co-operated with America in the war on Iraq.

Yet the terrorists have suffered a series of defeats. Al-Qaeda's Afghan camps have been closed down. Though Mr bin Laden is thought to be hiding somewhere along the Afghan-Pakistani border, and some of his associates to be in Iran, George Bush claimed recently that nearly half of al-Qaeda's leaders have been killed or seized, including Khalid Sheikh Mohammed, a henchman detained in Pakistan earlier this year. Senior captives (not the foot-soldiers cooped up in Guantanamo) are said to be talking to their captors. The terrorists are finding it harder to move money (and themselves) around the world.

These trends are not incompatible: al-Qaeda is as much a movement as a coherent organisation, which makes judgments about its fortunes tricky. It retains a leadership structure capable of orchestrating violence; the simultaneous strikes in Riyadh may well have been its doing, as both the Saudis and the Americans think. But the leaders also co-operate with a variety of other more or less autonomous groups. Moreover, Mr bin Laden's cause commands the sympathy of tens of thousands of *jihadis* who graduated from the Afghan camps before scattering around the world, a cadre that dwarfs the few thousand suspects who have been detained globally.

Some of these are thought to have formed their own independent outfits, leveraging local grievances to recruit accomplices. The attacks in Casablanca may fall into this category, though Moroccan officials believe that they had international backing (see article). Along with Jordan, Nigeria, Pakistan, Saudi Arabia and Yemen, Morocco was deemed ripe for liberation in a message purportedly from Mr bin Laden that surfaced in February. Other individuals are simply inspired by his example and apocalyptic ideology.

Terrorism has a complex ecology, inhibiting generalisations. But two deductions can be made from recent events. The first concerns tactics. Al-Qaeda and its affiliates have been concentrating on so-called “soft” targets: civilians and the economy in developing countries.

Like other terrorist groups, albeit more murderously, they are especially victimising the tourist industry. Casablanca falls into this pattern, as did last year's strikes on a Balinese night-club and a Kenyan hotel. The aim is to drive out the infidels and damage local economies, and thus the regimes that preside over them. Killing Americans and other westerners, even at the cost of large numbers of “martyrs”, generates massive publicity. Suicide remains a favoured technology.

A repeat of September 11th?

The second lesson is geographical. Saudi Arabia has furnished al-Qaeda with much of its personnel and cash; perhaps for that reason, attacks in that country had not, until last week, been commensurate with the terrorists' denunciations of its rulers. That seems to be changing. There have been murky and contested reports of a hijacking plan, based on September 11th, being foiled this week at Jeddah airport. For their part, the Saudi rulers appear more determined to suppress the militants, and have begun to be more successful than in the bungled raid that seems to have allowed some of the Riyadh bombers to escape just before carrying out their crimes.

None of this means that al-Qaeda's leaders have given up on the “far enemy”, America, or that it is incapable of plotting massive strikes against it. Intelligence from captives suggests the reverse. This war is bound to prove much longer, tougher and less conclusive than the war on Iraq.

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Moroccan bombings

Synchronised crime

May 22nd 2003 | RABAT
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Morocco quickly identified the culprits. Perhaps too quickly?

WITHIN 48 hours of the May 16th suicide bombing of five targets in Casablanca, including a hotel, a Spanish restaurant and a Jewish community centre, the Moroccan authorities had declared them the work of a home-grown Islamist fundamentalist group, al-Assirat al-Moustaquim (the Righteous Path). Twelve bombers died, along with their 29 victims (most of the victims were Moroccan citizens but also Spanish, French and Italian).

Two Moroccans, allegedly involved in the bombing, were captured and are in the unkind hands of the security services. Mustapha Sahel, the interior minister, claims evidence of an international connection, there is talk of al-Qaeda subcontracting to a local group or groups prepared to accept high suicide casualties.

Security policemen descended on Sidi Moumen, the low-income Casablanca suburb that is reputed to be the Righteous Path's home turf. The group had been known as a neighbourhood vigilante group with a strong religious bent. In February last year, a handful of its gang members cornered a local man known for his drinking, and stoned him to death. It is part of a fringe movement of ultra-conservative Islamists, called the Jihad Salafists by the security services.

Salafists are literalists, seeking the strict application of holy texts. As recently as a year ago, young Salafist men in Afghan-style dress were offering recorded sermons praising Osama bin Laden from market stalls in Moroccan towns. Then the security services began a crackdown, picking up men with Afghan experience, and questioning them in unofficial detention centres for weeks or even months.

Spain may have been targeted because of its support for the Iraqi war; the Jews because of Israel. But it is Morocco that has been hurt. The bombings have been widely interpreted as an attempt to undermine the stability of a system that still has an executive monarch at its pinnacle, but which ministers repeatedly insist is undergoing a democratic transition.

Despite official assurances that arrests made in the course of the investigation will follow the judicial process, liberals fear that the bombings may provide the pretext for an authoritarian backsliding. The sentencing of a journalist, Ali Lmrabet, this week to four years in prison, for articles and caricatures supposedly disrespectful of the monarchy, bodes badly.

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Baghdad faces anarchy

Freedom, but without law and order

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We need electricity, not a minister of electricity, say Iraqis

EPA

ENSCONCED in the marble luxury of Saddam's palaces, Iraq's American administrators are mostly guarded from the anarchy that their six-week occupation has brought to Baghdad. Beyond the barbed wire, looters plunder the city unpunished, electricity and water are a rarity, and multi-lane, multi-mile-long queues for petrol snake through the city.

The Iraqis are long suffering: despite the absence of law and order, pre-war predictions of civil war and rampant revenge-killings have yet to visit this city of 5m people and as many guns. But they despair at the ineptness. The electricity cuts have proved a boon for looters and gunmen working in the unlit darkness of the night, and the lawlessness now extends to daylight. Unarmed policemen watch helplessly as thieves rob a car in front of their station; a judge sits in the burnt-out shell of his court-room, the ash of previous judgments blowing in the air.

At the gate of Baghdad's Mustansiriya University, a physics professor with a Baathist past was lynched for molesting a girl. Neighbours wail of daughters kidnapped from cars caught in traffic jams, and of a market trafficking women emerging in a dilapidated old Jewish quarter. Fathers keep their girls trapped indoors, and grenades trade for the price of a few felafel.

“We waited 35 years for freedom, but now we are sad,” says an accountant, whose life-savings were lifted by bank-robbers. Money-changers play havoc with the exchange rates. The cost of many everyday things, such as ice, has doubled, and the cost of services has tripled.

Americans try to explain the disarray. The electricity plants were undamaged by bombs, but the grids may have been sabotaged. The oil fields cannot produce petrol because looters have pillaged the water-pumping installations. Mindful that no Iraqi respects an unarmed policeman, the Americans have taken to sending tanks to follow patrol cars.

Banishing the experts

Exacerbating the chaos is the zeal of Paul Bremmer, the new head of the Office of Reconstruction and Humanitarian Assistance (ORHA), for de-Baathification. To weed out the old guard, Mr Bremmer's men have supervised internal elections for the new administrations of institutions, ranging from Baghdad

University to the State Oil Marketing Organisation. This leads to complaints of upside-down management. The United Nations is at a loss how to administer the remaining six months of the oil-for-food programme after three-quarters of the director-generals at the Ministry of Planning responsible for the distribution of rations—one of the more efficient operations of the old regime—were elected out of office.

“Why can't they bring back the traffic wardens? They are not war criminals,” asks Wamidh Nadhmi, a politics professor at Baghdad University and a long-time Saddam critic, now sunk in depression. ORHA's young officials, devoid of Iraqi experience, say they are seeking to proceed by consensus among the country's myriad constituencies, and this takes time. Mistakes could prove costly. But most of their energy seems devoted to political reconstruction, co-ordinating with the posse of exiles they helped bring back to Iraq. We need electricity, not a minister of electricity, respond Iraqis.

For many who have lived through the hell of Mr Hussein, the incoming exiles are regarded as little better than looters. People make an exception of Adnan Pachachi, an elder statesman and former foreign minister, but accuse other foreign-backed groups of pillaging their party headquarters. “They came saying they are our representatives, and then, with American protection, went on the rampage,” said a woman in the smart suburb of Mansour, whose home lies within a stone's throw of seven houses, two clubs and two schools occupied by the new arrivals.

After 30 years of war, sanctions and Baath rule, Iraqis are exhausted. Many are still too dependent on the state to take their fate into the own hands. But with temperatures pushing into the 40s, a summer minus generators is curdling tempers.

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Baghdad's Shia militia

The people who now run the slums

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In the absence of an administration, the clerics have taken over

IN TOPJI, a poor area on the edge of Mansour, Baghdad's smartest suburb, a Shia cleric, Bakr Muhammad Basri, has taken control, filling the power vacuum. Aged 36, he has a physics MA as well as his three years at a religious seminary, or Hauza, in Najaf. This enterprising cleric has, among much else, rewired the generators in a nearby textile factory to power the neighbourhood when the mains fail, as they constantly do.

He has commandeered Saddam Hussein's personal bakery to supply the masses, and he has supervised the looting of medicines from state warehouses to redistribute them free to local hospitals. He also drove a crane to the main roundabout to yank down the statue of Hassan al-Bakr, Saddam's predecessor as president, who had had his father, a leading imam, executed 30 years ago.

His henchmen, taking charge of Topji's 15 schools and two colleges, have ripped the photos of Saddam from all textbooks, and banned a course called *wataniya*, literally patriotism, but better translated Saddamism. As part of the rewriting of history, Yasser Arafat Boulevard has been renamed Imam Mahdi.

Mr Basri claims his followers are armed with no more than their moral authority. Sunni Palestinians in his neighbourhood tell a different story of gun-toting toughs ousting them from their homes. Baath apparatchiks have been ordered to hand over their guns, and stay indoors, tantamount to house arrest. Before Saddam's fall, there were only two organised forces in Iraq, the Baath Party and the Hauza. With the United States committed to de-Baathification, the clerics face an open field.

In the sprawling impoverished estates of northern Baghdad, their authority is even more striking. The imam of Hikma mosque, Muhammad Fartosi, claims to control 2m Shias with his 90 young theological students from Najaf, plus some 1,000 toughs from the slums. This army of street boys, on a salary of a dollar a day, direct the traffic at key intersections and pile up the rubbish, giving the shanty-town some of the fastest-flowing and cleanest streets in all of Baghdad.

His acolyte, Ali al-Rawawi, age 23, is the “mayor” of Gayera, a district of 200,000 people, and responsible for a workers' committee that is repairing six telephone exchanges. Another theological student helped stage elections for a new executive for the artists' union. The union then signed an agreement to staff the clerics' television channel, once they can get an outside broadcast unit looted from the Information Ministry to work.

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Iraq's lost antiquities

Who's to blame?

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A move is afoot to blacken the museum's name. This may not be just

"AS SOON as there's a government that decides that others should do this job, they're welcome," says Donny George, the research director at the Iraq National Museum. He thus acknowledged his own vulnerability to the de-Baathifying zeal of Pietro Cordone, the Italian diplomat whom the Americans recently put in charge of Iraqi culture. Visiting foreign archaeologists expect top people from the board of antiquities, Mr George included, to be pushed out. But they are suspicious about the reason: "The Americans are covering their ass," suggested one.

AP

Donny George (right) and returned beauty

American forces were criticised last month for not preventing the theft of thousands of pieces, including some treasures of Mesopotamian culture. They took three days to make good on a pledge, delivered to Mr George, to dispatch a protective force. Now some American officials are insinuating that the museum staff handed the premises over to Iraqi troops, who used them as a defensive position.

Matthew Bogdanos, a New York homicide prosecutor who has been carrying out an inquiry, attributes American slowness to the fact that the museum had been turned into a "combat zone". In a report he put out this week, Mr Bogdanos said that the area around the museum was secured by a tank platoon only after "fierce fighting". Not fierce enough, it would seem, to deter the dozens of journalists who greeted the tanks as they hove into view.

Mr Bogdanos claims to seek the lost treasures, not scalps. But his insinuation that keys to important rooms in the museum were removed from a director's safe seems designed to suggest an inside job. In his report, he notes that his efforts to recover lost items have been hampered by the links between the museum staff and the Baath Party, and by the museum's incomplete record-keeping system.

Mr George, whose good English and personable manner make him the museum's public face, endeavours to answer such allegations. His assertion that the museum's archive is adequate and complete is endorsed by foreign colleagues. He maintains that the safe was opened by a safebreaker, whose keys were found on the premises. For the foreign archaeologists who now throng the museum, the idea that their colleagues could have colluded in its desecration is too appalling to contemplate. They tend to take a relaxed view of the Baathist credentials of Mr George and the head of the antiquities board, Jabir Khalil Ibrahim; no one in a senior position, they say, was unqualified.

Since the looting, nine works of art from the public galleries, and hundreds more from the stores, have been returned, many from repentant locals. That still leaves a lot of missing artefacts, and Mr George fears that the finest pieces may have already left the country.

And what has happened, or is happening, to museums and sites outside Baghdad? On American insistence, the remit of a UNESCO mission to the country has been severely curtailed. The mission is confined to Baghdad and its environs, so delegates have not been able to see more distant archaeological sites that, local officials report, have been severely looted by armed gangs. And Mr Cordone has declined to allow journalists to accompany him on a helicopter trip he plans to make to some of these plundered sites.

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Iraq and the UN

Making it legit

May 22nd 2003
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A Security Council resolution on Iraq is expected to be passed this week

AFTER three revisions of their original draft resolution, America and Britain were set to win the UN Security Council's blessing for their role as the occupiers and rulers of Iraq until such time, still undetermined, as Iraq has an elected government of its own. An interim Iraqi administration is to be appointed, possibly some time in July, but this will have consultative duties only. Decision-taking, on all matters from building the nation to managing its oil, will be the job of the occupying authority.

Praise be, the resolution (which, after France, Russia and Germany withdrew their objections, was expected to be passed on May 22nd) brings nearly 13 years of harsh sanctions to an end. As a concession to countries, including Russia and France, that have big contracts under the oil-for-food programme (the exchange of Iraqi oil for humanitarian supplies), the process will be phased out in six months rather than the four originally envisaged.

A sticking-point, in earlier drafts, was the small, exclusively humanitarian, role that the Americans and British allowed the United Nations. This has been amended, at least in words, though it remains vague what the UN will actually be permitted to do apart from contributing to Iraqi well-being. The “special co-ordinator” that the UN secretary-general had been told to send to Iraq has been promoted to a “special representative” with “independent responsibilities” to co-ordinate, promote and facilitate Iraq's reconstruction, including the “process leading to an internationally recognised, representative government”.

The latest draft does not call for UN peacekeepers or for UN weapons inspectors, though it does make provision for the Security Council to “revisit” the mandates under which the inspectors formerly operated. It also opens the way for other states “that are not occupying powers” to come to Iraq and work under the occupying authority. The last four words point to the essence of the resolution. Its wording is smoother than in the original drafts, but it still legitimises the exclusive string-pulling power that America and Britain have over Iraq's political and economic future.

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Israel and the Palestinians

Rushing backwards

May 22nd 2003 | JERUSALEM
From The Economist print edition

A wave of suicide bombings could sweep aside the road map

Get article background

"WE'RE still on the road to peace," George Bush assured the Middle East protagonists this week. "It's just going to be a bumpy road." Mr Bush was telephoning Israel's Ariel Sharon and the Palestinians' Mahmoud Abbas, on May 20th, after five Palestinian suicide bombings in three days stalled the new peace effort as it took its first tentative steps forward.

The weekend had appeared to offer a frail glimmer of hope. On May 17th Mr Sharon and Mr Abbas had their first encounter since Mr Abbas was appointed Palestinian prime minister, and Mr Sharon planned to fly to Washington the next day for talks on the road map with Mr Bush and his team. Two hours before the May 17th meeting, a suicide bomber killed a settler couple on their way to a synagogue in Hebron. Six hours after the meeting, another bomber blew himself up on a bus in Jerusalem, killing seven people. Minutes later, also in Jerusalem, a third young member of the same Hamas cell committed suicide by a police road-block.

Mr Sharon cancelled his Washington trip. Next morning, a suicide bomber in Gaza attacked an army vehicle, injuring three soldiers. In the afternoon, a young woman bomber targeted a shopping mall in the northern town of Afula. She was stopped at the entrance by a security guard, who was killed along with two shoppers when she set off her charge.

Israeli intelligence officials gave warning that the wave was not over. They accused Yasser Arafat, who is still besieged in his Ramallah headquarters, of "signalling encouragement" to Islamist radicals. The Israeli government, arguing that Mr Arafat was trying to undermine his own prime minister, announced that foreign statesmen who visited him would not be received by itself. The Palestinian territories were sealed off, and tight closures were reinstated around Palestinian towns and villages, paralysing all movement.

Two monologues

The May 17th meeting produced an agreement to meet again. Otherwise, the two leaders talked past each other. Mr Sharon focused exclusively on the Palestinians' duty, under the terms of the road map, to curb terrorism. He called on them, as the map says, to "immediately undertake visible efforts on the ground to arrest, disrupt and restrain individuals and groups conducting and planning violent attacks on Israelis anywhere." He offered to withdraw troops from Palestinian cities if the Palestinian Authority was prepared to assume responsibility for security.

Mr Abbas dwelt on Mr Sharon's failure to proclaim his unequivocal acceptance of the road map, which provides for a provisional Palestinian state by the end of 2003, and a permanent two-state solution by 2005. Mr Sharon insists that the dismantlement of Jewish settlements, part of Phase I, is "not currently on the agenda". Mr Abbas and his security chief, Muhammad Dahlan, assured the Israelis that they had a security plan and were prepared to confront Hamas and Islamic Jihad—but only in the context of a broad and explicit political accommodation. The Palestinian people, they argued, needed to see that counter-terrorism measures were part of the process leading to their independence.

To Mr Sharon, and later to Mr Bush on the telephone, Mr Abbas urged an end to the Israeli badgering of Mr Arafat. It made his own domestic political position even less tenable, Mr Abbas argued. But Mr Sharon has political problems, too. On May 19th, 23 of the 40 Likud members of parliament signed on to an anti-road-map lobby run by the settlers. His coalition, which includes two parties to the right of the Likud,

grows more restless with each new bombing. Mr Sharon's aides say that, to give Mr Abbas “a chance”, there will be no drastic reprisals. But if the attacks keep up, that policy may waver.

Reports from Washington at midweek suggested that Mr Bush might move beyond exhortatory phone calls to inviting the two leaders to meet him, perhaps as early as next week. A flurry of high-profile American diplomacy would indeed be the only action likely to impress the doubters and faint-hearts on both sides.

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Belgium's general election

A model for Europe?

May 22nd 2003 | BRUSSELS
From The Economist print edition

Belgium's peculiar system of national politics is failing to heal ethnic divisions or to stem the rise of the xenophobic far-right

AP

AT THE European constitutional convention under way in Brussels there is much talk of the emergence of a European “demos”—a single European people who might one day form a genuine polity, complete with pan-European politicians and parties. Last week George Papandreou, Greece's foreign minister, became the latest European heavyweight to call for the direct election of a president of Europe.

The delegates arguing for the existence of a European demos might be a little less confident if they read the local newspapers in Belgium. Forget about Europe; there is still no Belgian demos. Linguistic divisions have proved too powerful to create a single political culture even in a small country of 10m people—a fact demonstrated once again by the Belgian elections of May 18th. Indeed, the very term “Belgian election” is misleading. Two elections were held on the same day in the country called Belgium, featuring different parties and leaders, depending on whether the vote was taking place in Dutch-speaking Flanders or French-speaking Wallonia.

In the Flemish election the Liberal party led by Guy Verhofstadt (pictured), the Belgian prime minister, won a narrow victory ahead of the Flemish socialists, Christian Democrats and the far-right Vlaams Blok. In the francophone elections the francophone Socialists emerged as the biggest party, just ahead of the francophone Liberals. The only genuinely common theme was the Greens' collapse—in both Flanders and Wallonia.

Belgian politics now requires the various political parties to form a governing coalition. An unstated requirement is that the prime minister almost certainly has to be Flemish, given that 60% of the population are Dutch-speaking. No Walloon has got the top job since the 1970s. So it is all but certain that Mr Verhofstadt will continue as prime minister, probably at the head of a four-party coalition of Liberals and Socialists.

A second term in office will let the boyish 50-year-old prime minister start working on his image as a European elder statesman, perhaps with a view to landing a top job in the European Union. But further years of a Verhofstadt government will also underline the extent to which politicians are hamstrung by the consensual coalition-building ways of Belgian politics.

When Mr Verhofstadt first emerged on the national scene, he was a vigorous and unusual proponent of economic liberalism. He was even nicknamed “Baby Thatcher”. Yet, though his political origins place him on the centre-right, the need to form a coalition with the Socialists means that he has had to govern from the centre-left. The early Verhofstadt who spoke of privatisation and the need to encourage entrepreneurs has given way to a prime minister who flirts with the anti-globalisation movement and whose liberalism is largely expressed through social legislation, such as the legalisation of gay marriage and euthanasia.

Mr Verhofstadt does have some solid economic achievements to his name. The national budget has been balanced and a start has been made to reduce the Belgian state's awesome national debt. But the economic climate is now worsening. Belgian unemployment has reached 11.6%, up by more than 1% since last year, and there are big job losses in store in Wallonia's steel industry. That is particularly bad

news, since unemployment in francophone cities like Liège and Charleroi already runs at around 35%.

Swollen Blokheads

Bleaker economic times may help the far-right Vlaams Blok, which campaigns against immigration and for an independent Flanders. Its share of the vote in Flanders rose, as it has done in every national election since 1981. This time it got nearly 18%, up from 15% in 1999. The mainstream parties will continue their policy of a “cordon sanitaire”, in which all parties agree to refuse to form a coalition with the Blok.

But privately many mainstream politicians feel the policy is backfiring, since it promotes the Blok's image as anti-establishment—thus boosting its popularity. That is certainly happening in the party's power base in Antwerp, Belgium's second city, where the entire city council has had to resign after a scandal and where ethnic tensions are very high between Muslim immigrants and the white working-class. For the Vlaams Blok the national elections of 2003 are just an interlude. Its sights are set on the mayoral election in Antwerp in 2006—which it looks likely to win.

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Spain's municipal and regional elections

A dry run for next year

May 22nd 2003 | VALENCIA
From The Economist print edition

The voting is local but the campaign has been a national one

IT'S the Spain you don't read about, except in holiday brochures and football reports: no terrorism except the rare Basque bomb, no separatists, no big regional party even, no crumbling economy, few huge demos, no recent natural or man-made disasters. Yet it is the "middle Spain" typified by Valencia's 4.2m people and their everyday concerns—crime, jobs, housing—that will decide the country's municipal and regional elections on May 25th, and quite possibly, its future national politics too.

In theory, these are local elections: for town councils in all of Spain, regional assemblies in 13 of the 17 regions. In Galicia, the vote will reflect official mishandling of last year's huge oil spill from the sunken *Prestige* tanker; in the Basque region, ETA terrorists and the recent ban on their political party; in Aragon, the national water plan that will divert some of the Ebro's ample flow to the dry south-east; in Catalonia, the challenge of local socialists to the powerful regional party; in the south-east, dreams of that much-needed water; in the far south, a local scandal or two, or the inflow of illegal migrants, also much needed but little loved, from Morocco. Yet in political fact the elections have become a prelude to next spring's national election.

For that, thank José María Aznar, prime minister since 1996. While keeping that post until after the election, he plans to step down from his unchallenged leadership of his People's Party (PP) this autumn. You would not guess it from the vigour of his campaigning. A few weeks ago, the PP's prospects looked dim. It had provoked a general strike last year with widely disliked labour-law reforms. The *Prestige* had become a national scandal, hurting Mr Aznar and Galicia's PP government alike. Above all, he had eagerly backed the Iraq war, defying 90% of public opinion.

Yet he has turned the tide, emphasising his iron handling of ETA and his contempt for Basque or any other regionalism. Above all, he asks, do voters want to let a "red" coalition—ie, the soft-left Socialist Party and the far left—put at risk the economic gains of his years of power? In PP-run Madrid, polls show a shift putting left and right now neck-and-neck. Not so in Valencia, it too run by the PP. There, the pollsters say it should win again.

One reason is indeed the economy: over the past 25 years, the region has seen an average of 3% annual growth, well above the national average. Another is the nature of that economy, heavily dominated by services. Tourism, based on natural resources of sun and sea, has disfigured much of the region's coast, but it also supplies 12% of regional output. Roads, both coastal and inland towards Madrid, have much improved. The city of Valencia sees itself as Spain's natural outlet to the Mediterranean, and its port has overtaken that of its rival, much bigger Barcelona.

Agriculture, of course, has lost its old significance. But Valencia never had much heavy industry, to suffer from global competition. Old sectors like textiles and shoes have naturally shrunk, but ceramics—tiles and the like—survives. Today's big employer is a Ford car plant, with 7,000 workers. But outside the public services, small employers dominate all sectors. Hence, in part, a weak trade-union movement.

Other reasons lie in the PP itself. Its long-time regional boss, Eduardo Zaplana, head of the regional

government for seven years until 2002, and now minister of labour in Madrid, was boss indeed, and in practice he still is. This is a pretty united party, as the local Socialists are not.

The city itself, 760,000 people in a metropolis of some 1.2m, is run—from a mayoral seat whose “crystal hall” would embellish any royal palace—by one of the few PP people Mr Zaplana could not boss around: Rita Barberá, mayor since 1991, and expecting to stay so. Populist as much as PP, she has overseen big changes (some planned when we ran the city, say the Socialists—but who cares today?). For glamour, and tourists, Valencia now has a glistening modern “city of arts and sciences”, including, since December, a splendid aquarium. For daily use, it has a modern metro, good buses, clean streets, reasonable (and restrained) local taxes. It also has one notorious slum area, and too little low-cost housing; so does every big city in Spain. Crime is a big, if exaggerated, public worry. Jobs are another, though the unemployment rate is well below the national 11.7% average. But this is a visibly well-off city, down to the call-girls whose ads fill four pages of one local daily paper.

Not surprisingly, prosperity has helped the PP eat into the once sizeable regionalist vote; and what's left is now shared by two parties, neither of which may get over the 5% threshold to win any seats at all. That is a big bonus in a country where local parties run three regions and often hold the balance of power at that level or at lower ones. And, as elsewhere, Valencia's PP has another advantage, say its friends: like his views or not, Mr Aznar has a single, national message, while the Socialists trim from one region to the next.

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France's Socialists

Against change

May 22nd 2003 | PARIS
From The Economist print edition

At their annual conference, France's Socialists recoil from being radical

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"THE Socialists are back!" proclaims François Hollande, first secretary—and therefore official leader—of a party that France's voters swept from government in last summer's general election, having first humiliated the Socialist candidate in the presidential election a few weeks before. "From the Congress of Dijon we are leaving stronger, more united, more determined." All of which, claimed Mr Hollande, as the congress ended on May 18th, signals "bad news" for France's centre-right president, Jacques Chirac, and his prime minister, Jean-Pierre Raffarin. "The pendulum is starting to move—and democracy is alive again."

AFP

Hollande is still a bit flat

Really? Restoring party morale with three days of rousing speeches is the easy bit; winning power "after the terrible April 21st", when the Socialists' candidate was knocked out in the first round of the presidential election by the far-right's Jean-Marie Le Pen, will be the hard part. The big question is whether the party should modernise itself, taking the same "third way" as Britain's New Labour, or go back to its roots, forsaking the liberal economic heresies of Tony Blair and his kind.

To judge by this week's gathering, the party intends to duck the question. After all, the next presidential and general elections are not until 2007, and next year's regional and European ones will depend not so much on grand ideas as on making the party machine run smoothly. Hence a recruitment drive to add to the party's 130,000 members, and an appeal to all France's parties of the left to collaborate in their choice of candidates. Does that imply a grand new party of the left to match the Union for a Popular Movement (UMP) created by the right last year? Mr Hollande is coy: "There's no need to get married in order to live happily together."

Meanwhile, the Socialists' tactic is to attack the government wherever possible—on the proposed reform of the pension system, on the rise in unemployment, and so on. When France's workers by the hundreds of thousands are taking to the streets (and a current teachers' strike is threatening to muck up end-of-year exams), it makes for easy popularity. Significantly, one of the biggest cheers of the congress was for the arrival of Bernard Thibault, head of the Communist-dominated CGT trade union. On the eve of the

congress, two other leading unions had accepted the government's pension reform, but the CGT remains opposed, calling for yet more street protests before the reform goes before parliament next month.

The trouble with attacking the government on every front is that this smacks of what one Communist parliamentarian terms “the Socialist Party's endemic opportunism”. A similar charge comes from the CFDT, one of the union groups that have agreed to the pension reform. Instead of taking the easy route leftwards, it argues, the Socialists should adopt “a social-democratic policy”.

In the Socialist Party's language that means following the ideas of Dominique Strauss-Kahn and Laurent Fabius, both of them finance ministers in the government that Lionel Jospin led to defeat last year, and both of them undeclared rivals for the presidential race in 2007. Mr Strauss-Kahn says his party has already chosen a reformist, modernising route. In the run-up to the congress the party rallied around the moderate Mr Hollande and consigned old-guard Socialists such as Henri Emmanuelli and Jean-Luc Mélenchon to the margins. Yet Mr Strauss-Kahn's speech at the congress was greeted with politeness rather than enthusiasm, despite his impassioned appeals for social justice and equality.

Mr Fabius got a much warmer reception for eloquently defending the secular state and attacking such overt forms of religious identity in public institutions as the headscarf for Muslim schoolgirls. But this, too, smacks of opportunism. The wearing of headscarves has resurfaced as a political controversy with the government-backed establishment last month of a French Council of the Muslim Religion—a body that has turned out to be dominated by traditionalists and fundamentalists.

In the short run, it makes political sense for Mr Hollande to embarrass the government by siding with the strikers. It makes sense, too, to stress the traditional values of the left in order to forge a common front on the left. Whether it will make sense for next year's elections or for those in 2007 is less certain. Bernard Kouchner, who was health minister in Mr Jospin's government, is unconvinced. He said that the Socialists' own proposals for pension reform were designed only to “dazzle the eyes”, and that their choice of strategy at Dijon boiled down to “a resistance to change”.

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European defence

Ready, or not

May 22nd 2003
From The Economist print edition

Europe's not-so-rapid-reaction force

Get article background

MODERN warfare, as military theorists have observed, is increasingly “virtual”—fought from a distance (by America, at least) and transmuted through television cameras. This week the European Union outdid even the futuristic Americans, announcing the creation of a virtual army, which exists mainly in the minds of enthusiastic politicians.

After the Kosovo conflict had yet again illustrated Europe's military reliance on America, the EU set itself a goal: to be able to deploy, by 2003, up to 60,000 troops, within 60 days, and sustain them in action for up to a year. This ambition is the mainstay of Europe's effort to develop some collective military clout. The force is supposed to act when NATO chooses not to, and to be capable of the full range of “Petersberg tasks”, a set of possible (mostly humanitarian) missions agreed upon at a German hotel of that name in 1992. On May 19th, Yiannos Papantoniou, defence minister of Greece (which holds the EU's rotating presidency), duly declared that Europe's army was now ready for action; and that this was “a great day, an historic day for the European Union”.

Not everyone was quite so sanguine. Geoff Hoon, Britain's defence minister, pooped the party, pointing out that it had taken Britain 70 days to deploy 45,000 troops to Iraq, and that there is a lot more to do if the EU's goal is to be met. Javier Solana, the Union's foreign-policy chief, said it needed to be done urgently.

The trouble is not the troops themselves: the force is not a standing army, waiting for its orders in barracks in Brussels, but an ad hoc coalition of suitable components. The trouble is the shortfalls in equipment which, despite years of ministerial talk about remedying them (and the possibility of borrowing some things from NATO), remain serious. The British are particularly worried about inadequate stocks of “smart” bombs, air-to-air refuelling capabilities, surveillance equipment and heavy-lift transport aircraft. The underlying problem is the reluctance of European governments to put their money where Mr Papantoniou's mouth is (in terms of both procurement and research) and duplication in what they do spend. Several governments this week blamed their predicament on the EU's Maastricht rules that govern public spending.

In practice, say the British, this means that the EU would struggle to perform the tasks at the tougher end of the Petersberg scale. As Daniel Keohane of the Centre for European Reform, a London think-tank, puts it, Europe “is ready for peacekeeping but not for peacemaking or war-fighting”. The EU recently took on a Lilliputian peacekeeping role in Macedonia, and it may yet be able to take over the much bigger job in Bosnia from NATO next year. But it would probably not be able, for instance, to intervene on its own to stop war in the Congo. “The thing is a total mess,” says Sir Tim Garden, a former British air marshal.

And even if the force were ready in practice as well as in theory, would Europe's politicians be ready for it? When and how Europe should act independently of America and NATO, and how gung-ho it should be, are questions that will stay contentious even after the Iraqi hatchet has been buried, though Poland's request this week for NATO to help with its peacekeeping in Iraq may help to speed that process. Even those Petersberg tasks are open to interpretation.

Mr Solana is working on a new European security doctrine to resolve such issues. He shouldn't count on the rapid-reaction force just yet.

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The euro zone

Not so easy to join

May 22nd 2003 | PRAGUE
From The Economist print edition

A good week for the euro, but less good for countries wanting to adopt it soon

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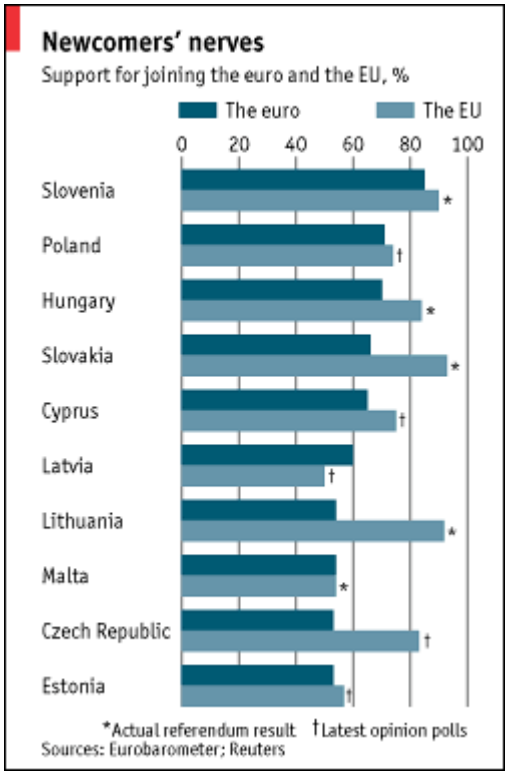

AS THE euro was hitting four-year highs against the dollar, Pedro Solbes, the European Union's monetary-affairs commissioner, was telling the ten countries waiting to join the EU in 2004 that they will find their next challenge, qualifying for euro-zone entry, tougher than they have been expecting.

Most of the EU newcomers have said they want to adopt the euro quickly. They know that as one precondition for doing so they will have to keep their national currencies stable against the euro for at least two years after joining the EU. But they expected "stable" to mean keeping a currency within a band of 15% on either side of a central rate against the euro. Wrong, said Mr Solbes. Euro-zone finance ministers will insist on a 2.25% band, he said—a much trickier proposition. The EU is, in effect, beefing up its signals to the accession countries that they should worry more about restructuring their economies and less about rushing to join the euro, which they are obliged to do sooner or later.

As it happens, some of the accession countries are starting to agree. They see how painful it will be to comply quickly with another rule of the euro-zone, the obligation to keep national budget deficits within 3% of GDP. Even some established euro-zone economies such as France and Germany are finding the deficit rule too strict, though they invented it. It will be more demanding still for some of the accession countries, struggling to meet big social obligations and revamp antiquated infrastructure inherited from communist times. Hungary's deficit hit 9.5% of GDP last year, a figure the IMF called "startling".

Goldman Sachs, an American bank, says it detects "increasing underlying political weakness" in some accession countries when it comes to tackling big deficits, leading to delays in adopting the euro. It no longer expects Poland and Hungary to join by 2007, its previous scenario.

The accession countries worry that until they join the euro-zone their borrowing costs will be higher, their currencies more vulnerable to attack, and their political heft diminished within the EU. But their preparations to join the Union remain firmly on course. A referendum in Slovakia on EU accession produced a 92% yes vote last weekend. Poles vote on June 7th and 8th. They too are likely to say yes, but analysts fear a turnout below 50%, which will mean the final decision must be taken, less gloriously, by the parliament.

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Swiss referendums

Turning yellow at the edges

May 22nd 2003 | GENEVA
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The Swiss are still green-minded—but wary of becoming extravagantly so

IN THE 1980s, the otherwise conservative Swiss cut a pioneering dash towards greenery. They imposed what were then Europe's toughest anti-pollution rules on cars. Recycling bottles and putting cans, batteries and vegetable waste in separate containers became a way of life earlier than for most Europeans. In some cantons you have to pay stamps for bin bags to discourage too much rubbish from being thrown away.

In a referendum in 1990, voters endorsed a ten-year freeze on the building of new nuclear-power plants. Four years later, the Swiss defied their government by banishing heavy trucks from Alpine highways. This annoyed Switzerland's European Union neighbours, by making them switch a lot of their transalpine freight to trains by the middle of this decade.

How green are you?
Swiss referendum results, % of valid votes

Question	Yes	No
Should we try out car-free Sundays four times a year?	37	62
Should we renew the present moratorium on building nuclear-power facilities?	42	58
Should we eventually shut down nuclear-power plants and use alternative energy sources?	34	66

Sources: IFES; Swiss parliament; swisspolitics.org

However, judging by the results of a batch of referendums on May 18th, the green ardour of the Swiss may be waning. Several verdant proposals were turned down—one for a new moratorium on building nuclear plants, another for the eventual total phasing-out of nuclear power, and a third for car-free Sundays four times a year.

Indeed, the mood may even swing the other way. A road lobby is drawing up a referendum proposal to bore another hole alongside the existing St Gotthard road tunnel. That, say its backers, would double the road-tunnel capacity and unblock the frequent traffic jams on the main motorway through the Swiss Alps.

In the 1980s, the Swiss had plenty of reminders of the fragility of their surroundings. Acid rain hurt their forests. The Chernobyl nuclear accident in Ukraine put a radioactive cloud over Switzerland. But in those days the Swiss felt they could afford to fend off threats to their environment. Now their economy is stagnant. Ending all nuclear power (which provides 37% of Swiss electricity) and making symbolic gestures, such as occasionally giving motorways over to cyclists, now seems a little extravagant.

Still, Switzerland's mainstream parties have all been forced to become fairly green-minded—and are likely to remain so. The country's four-party government had few qualms about signing the Kyoto Protocol on climate change in 1998. The Swiss have accepted curbs on carbon-dioxide emissions. The country's small Green Party has gained ground in elections to parliaments in Switzerland's cantons, which have the biggest impact on everyday lives. A study by the GfS research institute in Berne this month found that 70% of the Swiss want their public authorities to keep up their spending on the environment. It is just that they don't want to be bossed around by what they deem to be green zealots getting above themselves.

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Charlemagne

France's man on horseback

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From The Economist print edition

With France galloping on apart, relations with America will not easily be repaired

“THE standard-bearer of great collective ideals: the rights of man, the nation-state, the spirit of conquest, the emancipation of peoples and countries.” George Bush might regard that as an apt description of America's role in Iraq—apart, obviously, from “collective” and “spirit of conquest”. Actually, it is a description of Napoleon by none other than Dominique de Villepin, the French foreign minister, in a best-selling book on the French emperor. As a diplomat Mr de Villepin has become famous for his claim to internationalism, and his denunciation of war. But as an author he is a romantic nationalist, not at all averse to exporting liberty by force of arms.

In the wake of the American-led liberation of Iraq, Mr de Villepin's intellectual defences look as shaky as France's diplomacy. But his pride and nationalism are a consistent thread in both his thinking and his policy. He continues to argue with fierce passion, whatever the audience, that the positions France took in the run-up to the war in Iraq were completely justified. And the French government remains grimly confident that American policy in the Middle East is more likely to foster terrorism than to suppress it. “The Americans have lit a match in a room full of gas,” is the verdict of a senior official.

Such views make it highly unlikely, unless there is a regime change in Paris, that the United States and France will enjoy any swift reconciliation. It is true that, in the short run, diplomatic fixes may be found. It looks likely, for instance, that the two sides will be able to agree to a new UN Security Council resolution on post-war Iraq, lifting sanctions and defining the roles of the UN and the coalition forces. Presidents Chirac and Bush may try to smile together for the cameras at next month's G8 summit in France. But do not be taken in. All the ingredients for continuing ill-feeling between the two countries remain: personal bitterness between their leading figures, deep suspicion of each other's motives, a genuine philosophical division, and a steady supply of controversial issues to aggravate the problem.

The ill-feeling is likely to endure for quite a time. The Americans argue that the French government was perfectly within its rights to disagree with that of the United States but that it crossed the line between ally and adversary when Mr de Villepin travelled to Africa to rally opposition to the United States at the UN. And other episodes still rankle. Take, for example, Mr de Villepin's initial refusal to say that he wanted the coalition to win the war; or an opinion poll which showed that a quarter of the French people actually wanted Saddam Hussein to win it. The French, for their part, regard American diplomacy in the approach to the conflict as dishonest and reckless, concentrating mendaciously on weapons of mass destruction, when all the time determined to go to war simply to change the regime.

Behind the name-calling is a serious division of philosophy and policy. The French still insist that the UN is the only source of legitimacy for armed conflict or for international recognition of a government. Senior American officials, however, do not accept that the UN can have a veto over when the United States can use military force. They add that the ultimate legitimacy of a new Iraqi government—or of any government—flows not from the UN but from the consent of the country's own people. The two countries also differ profoundly over the war on terrorism. France tells the Americans that they rely too much on military force, that they are naively optimistic about their ability to build democracies in the Middle East and dangerously insensitive to the feelings of people in the region. The Americans respond that France is too ready to tolerate rotten and dangerous regimes in the name of stability and international consensus.

This philosophical gap leads to clear divisions on policy. The French are very keen to get their troops involved in peacekeeping operations in Iraq under a UN umbrella and openly sneer at the capabilities of some countries in America's coalition of the willing. But the Americans laugh off the idea that they need French expertise to sort out Iraq. Nor are they rushing to extend an invitation, fearing it would just reintroduce the pre-war diplomatic conflicts into the post-war job of reconstruction.

A new gap may soon emerge over the other two countries in Mr Bush's “axis of evil”, Iran and North Korea. Concerns about North Korea's nuclear capacity have already been well aired. Worries about Iran may well go fast up the agenda when the International Atomic Energy Agency issues a report next month. In neither case is America promoting war. But in both cases it may want tougher and quicker action than the French may stomach.

It's getting lonely in Paris

And what of the other Europeans? If France is to avoid becoming miserably isolated in its prolonged stand-off with America, it needs support from its European Union partners. But the prospect of that is not looking rosy. Within the enlarged EU of 25 countries that will come into being next year, a clear Atlanticist majority prevails. Germany, France's key European ally over Iraq (and many other issues), shares many French misgivings about America, but is much less keen to risk a prolonged confrontation. The French comfort themselves that, in the long run, the EU may move in their direction. Public-opinion polls, across Europe “old” and “new”, showed opposition to the war in Iraq and considerable hostility to the United States. If that trend persists—and especially if the United States takes further controversial action over North Korea or Iran—the number of countries willing to swallow the idea that the EU should be a counterweight to America may rise.

For the moment, however, it is looking pretty lonely in the French foreign ministry. That may not worry Mr de Villepin. In his book on Napoleon he quotes approvingly a dictum of Georges Clemenceau, France's leader in the first world war, that “our country advances only through crisis and in tragedy.”

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Justice and the constitution

Wigs on the warpath

May 22nd 2003
From The Economist print edition

The home secretary's battle with the judges is good news

DAVID BLUNKETT, the home secretary, is known as a man with a short fuse. His hostility to lawyers is famous and his disagreements with the Lord Chancellor, Lord Irvine, legendary and loud. But his attack on the judiciary for seeking to undermine the will of Parliament goes well beyond an ill-tempered personal spat.

The deterioration in the relationship was evident this week as Parliament debated the government's criminal justice bill, which includes several measures that worry judges as well as civil libertarians. It allows for greater disclosure of defendants' prior convictions and takes away some of judges' freedom to set jail terms for murderers. The Lord Chief Justice, Lord Woolf, in a restrained rebuke to Mr Blunkett, said judges were “concerned by the tone and content of the debate”.

Tensions between home secretaries and the judiciary are hardly new. In the 1990s, judges overturned many decisions made by Michael Howard, a Conservative home secretary. But some new factors have sharpened the hostility between the judiciary and the government.

The immediate cause of the row is a series of defeats for the government on asylum and terrorist cases. The Home Office was, for instance, ruled to have acted illegally in denying benefits to six Afghan refugees because they had failed to apply for asylum at the port of entry. Mr Blunkett was furious. “Frankly,” he said, “I am fed up with having to deal with a situation where Parliament debates issues and the judges overturn them.” When the lower court's decision was upheld by the Court of Appeal, the home secretary's bluster quickly evaporated. But within days he returned to the attack, claiming that judges were “seeking to undo acts of Parliament”.

The legal profession is outraged. Sir Oliver Popplewell, a recently retired High Court judge, who is therefore free to speak his mind, described an article by Mr Blunkett as “whining” and politicians as “control freaks”. Lord Alexander, the chairman of Justice, a legal pressure group, complains that Mr Blunkett is engaged in “a dangerous and subversive attack” aimed at diminishing respect for judges. Describing the home secretary as “a populist hard-liner”, Lord Alexander says he is threatening the balance of the constitution.

But this row is not just about a few embarrassing cases: it is about a shift in power from the executive to

the judiciary, manifested mainly in the growth of judicial review. The incidence of these cases, in which the courts examine the legality and fairness of government actions, has increased over 30 years from just over 100 a year to more than 4,000. In a recent case, for instance, a man who was jailed for eight years after being wrongfully convicted of the robbery of a Post Office van secured £50,000 in compensation only after taking the Home Office to court. In another, the courts upheld the rights of prisoners to have access to the media so that they could campaign to have their convictions overturned.

Why is there so much more judicial review these days? Partly because there are so many more intrusive laws and restrictions; partly because people and businesses are increasingly willing to assert their rights; partly because there are more single-issue pressure-groups around willing to back such actions.

Politics may have something to do with it. There seems to be more judicial review when governments have big majorities. That may be because judges take it upon themselves to constrain the power of an overweening executive, or because governments unconstrained by strong oppositions are more likely to pass bad laws.

There seems to be more judicial review when governments have big majorities

But it is the government itself which has done most to encourage the growth of judicial review. The incorporation of the European Convention of Human Rights (ECHR), a sort of Bill of Rights, into British law in 1998 allowed judges to declare any law incompatible with the ECHR—a ruling that in practice requires the government to amend the law.

As a result, says Mr Blunkett, judges “routinely rewrite laws that Parliament have passed”. That's an exaggeration. So far the judiciary has used its new powers with restraint, as indicated by Lord Woolf, who has said that “a degree of conservatism is a virtue” in dealing with applications for judicial review. Only about a quarter of applications under the human-rights legislation have been upheld, and in only four out of more than 400 human-rights cases since the act came into force have the courts declared British law to be incompatible with the ECHR. Yet the ECHR plays a part in a trend which is having a big impact on the way government works at all levels.

Is this growing judicial activism a good thing? Not unequivocally. There are costs: judicial review leads to more paperwork, for instance, because civil servants have to be increasingly sure that they have followed procedures precisely as laid down in the statute. Failure to follow procedure is the main reason why the government loses judicial-review cases.

But for those, like this newspaper, who think that the British constitution (or lack of it) endows the executive with too much power, this new judicial activism is a welcome development. Britain's judiciary is a pale shadow of that in countries with written constitutions, such as America, where the Supreme Court constantly scrutinises the actions of the executive and the legislature in the light of the constitution. But the growing assertiveness of Britain's judges is an indication that things are moving in the right direction. The crosser Mr Blunkett gets, the better.

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Corporate killing

Thou shalt not corporately kill

May 22nd 2003
From The Economist print edition

Watered-down plans for a corporate manslaughter law

ARE company bosses getting away with murder? The Labour party has long thought so. It mooted a corporate manslaughter law in 1997 in the wake of a string of disasters including the *Herald of Free Enterprise* ferry disaster in 1987 and the Southall rail disaster ten years later, because none of the companies involved could be successfully prosecuted. A consultation paper was issued in May 2000, which suggested making directors of companies individually responsible. This week, some six years after the idea was first proposed, David Blunkett, the home secretary, seemed to revive the idea and back-track in equal measure, though given how much time the government has had to work on the proposals, detail is extraordinarily thin.

Existing law requires being able to point the finger firmly at a person in a company for a disaster (a "directing mind"), which is fiendishly difficult at big companies. Only small companies have been prosecuted.

Labour had wanted to make directors individually responsible. But on May 20th Mr Blunkett told Parliament that "criminal liability of individual directors will not be targeted" by the proposals. Framing a law targeted at individual directors (which would have been unique in the world) was proving hard; and business had, not surprisingly, been lobbying heavily against the idea.

Mr Blunkett now proposes that deaths caused by "gross negligence by the organisation as a whole" would make companies as a whole liable to unlimited fines. But since unlimited fines are already available under existing health and safety legislation, it's not clear how this proposed new law would change things.

Nor is it obvious that changing things is a good idea. Such a law could push Britain in the direction of safety-obsessed America, where litigation, rather than legislation, burdens business with large insurance premiums. On work-related accidents, one easily-measurable area of corporate killings, Britain's record is anyway rather good. According to the International Labour Organisation, there were 225 work-related deaths in Britain last year out of a working population of 27.2m. That's 8.3 deaths per million, compared with 38 per million, on average, in the EU, and 52 per million in litigious America.

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Business and the euro

Cooling

May 22nd 2003
From The Economist print edition

Businessmen have become wary about joining the euro

Get article background

HE BLEW hot, he blew cold. In a speech to business leaders this week, Gordon Brown said that euro membership could bring benefits to Britain. But the chancellor of the exchequer also insisted that he would not take risks with Britain's hard-won economic stability. That's code for a verdict of “not yet” when he finally presents on June 9th the Treasury's assessment of the five tests for joining the euro.

But suppose Mr Brown had surprised his audience at the Confederation of British Industry's annual dinner by declaring that the verdict was yes, Britain could now join the euro. How would business leaders have reacted?

Six years ago, when the first assessment of the tests was made, they would have been rapturous. In 1997, the CBI was gung-ho for early membership. So, too, was the Engineering Employers' Federation, whose members trade extensively with Europe. The CBI and the EEF articulate the views of bigger businesses and manufacturing exporters. But the British Chambers of Commerce (BCC), which represents smaller, more domestically oriented firms, was also in favour of joining the euro.

Since then, however, much of that early enthusiasm has evaporated. The CBI's stance changed markedly three years ago when Digby Jones replaced Adair Turner, a euro-enthusiast, as director-general. Mr Jones stopped promoting the euro cause and made clear that the CBI would wait for the government to make its own mind up. When Sir John Egan became CBI president a year ago, he said that business opinion on the euro had swung from being broadly in favour to being broadly neutral. Unlike the previous three presidents since 1996, Sir John is a euro-sceptic.

The BCC also changed its policy to a neutral stance after a poll of its members in 2000 revealed no more than a wafer-thin majority in favour of joining the euro. A more recent survey, published in January, revealed even greater scepticism. Only 35% thought that Britain should adopt the single currency as soon as possible. Even if the five tests were met, 49% said that Britain should wait and see how the euro developed before making a decision.

Businessmen accept that joining the euro is likely to boost inward investment and business competitiveness. But 63% of the BCC members said the government would be weakened in its ability to manage the British economy. And they had other worries: 68% thought it would lead to more regulation and 54% believed the tax burden would be higher.

The EEF agrees that joining the euro right now would be a bad idea. It wants the verdict on June 9th to put an end to continuing speculation about an early referendum, with any further decision postponed for four-to-five years. This stance reflects the fact that 55% of its members backed a “wait and see” approach when polled recently. They are especially concerned about the poor performance of the euro area and the encroachment of European regulations in social and employment law. Increasingly, engineering firms are looking to other parts of the world for growth opportunities.

The most important single reason for the change of mood among businessmen is that Britain seems to be making a better job of managing its economy. “We have now demonstrated that we can live outside the euro in terms of macro-economic stability,” says Ian McCafferty, the CBI's chief economic adviser. In his speech on May 20th, Mr Brown made another pointed reference to the “credibility and resilience” of the economic-policy regime “built around the Bank of England”.

The ebbing of business support for joining the euro is an important reason why hopes of early membership are likely to prove illusory. Public opinion remains consistently hostile by a margin of two-to-one to joining the euro. Britain in Europe, a pro-euro lobby, published a pamphlet this week arguing that “winning from behind” was possible provided that a broad coalition of support could be mustered. Maybe: except that the most crucial ally in such a coalition—business—is no longer prepared to report for duty.

Lukewarm

What businessmen say about joining the euro, %

If government says five tests met:

Join as soon as possible	35
Wait and see how the euro develops	49
Never join	13

Impact of joining:

	Higher	Lower
Regulation	68	4
Tax burden	54	4
Inward investment	43	16
	Stronger	**Weaker**
Business competitiveness	48	20
Government's ability to manage the economy	9	63

Influences on whether to support joining euro:

	More likely	Less likely
Improved economic performance in euro area	61	3
Reduced EU involvement in social and employment legislation	54	10
Government announcement that all five tests met	40	7

Sources: BCC/MORI; EEF/NOP

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Culture in Birmingham

High baltitude

May 22nd 2003 | BIRMINGHAM
From The Economist print edition

Culture and creativity are black and brown these days

ON JUNE 4th, one British city will be named European Capital of Culture 2008, and five others will be disappointed. Birmingham is pretty confident that it won't be in the second group. The city already boasts a fine symphony orchestra, several decent museums, and a respectable quantity of splashy architecture. Most importantly, Birmingham has a secret weapon, developed a few years ago by a group of restaurateurs: a type of curry known as balti.

In the most literal sense, balti is food cooked over high heat in a small wok. But the dish has a poetic and metaphorical force that extends well beyond the curry house. Last year, Birmingham's former “poet laureate” (it is the only city in Britain which appoints its own) Roi Kwabena celebrated the city's “cuisines galore/carnivals in the shadow of public art/an entire district dedicated to balti”. Birmingham's boosters say the cuisine represents the city at its best. Just as balti combines Pakistani and West Midlands culinary traditions, they explain, so the city incorporates different cultures in a creative and harmonious whole. They even fed some to the Capital of Culture assessment panel, to make sure they got the message.

The competition has seen a lot of talk like this. Liverpool and Bristol, two other cities that are still in the running for the cultural accolade, have touted their history as “world cities” (centres of the slave trade, sneer the Brummies). Last month, Liverpool threatened its citizens with the loss of the prize if they elected a BNP councillor. It is all very different from 1990, when Glasgow claimed the City of Culture title on the basis of its museums and administrative expertise. But diversity is *de rigueur* these days. On May 27th, Demos, a think tank, will unveil a “Boho Britain Creativity Index”, which ranks 40 British cities according to their ethnic diversity, proportion of gays, and patents per capita. According to these criteria, Birmingham is the 8th most creative city in Britain.

None of this seems to hold much appeal in Lozells, where many of Birmingham's black and Asian residents live. The area has escaped the propaganda blizzard that has enveloped the city centre, and questions about the Capital of Culture bid are met with blank looks. One young black woman pauses in the midst of buying pakoras to offer the heretical suggestion that the city has quite enough culture as it is. Aliur Wahid, manager of the Bangladeshi Youth Forum, says that “the people who come through these doors don't know much about it. But they should—they are being used to promote the city's bid.”

Birmingham's civic boosters furiously deny that they are using ethnic minorities as a window-dressing for their campaign—which, if successful, is unlikely to send tourists flocking to Lozells. They can talk up a storm about how the notion of culture has been expanded to take in more than museums. And they earnestly hope that the Capital of Culture folks agree, although, as Stephen Hetherington, the manager of the bid, admits, it's not clear what criteria the assessors are using, or even whether the government will pay any attention to them. “They might simply go for the most marginal constituency,” he says. “That, by the way, is Birmingham.”

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War aftermath

Henry V, pt II

May 22nd 2003
From The Economist print edition

The trouble with heroes

Reuters

Smoking gun

“HEROING,” wrote the comedian Will Rogers, “is one of the shortest-lived professions.” So it seems for Lieutenant-Colonel Tim Collins. He was taken up by the media at the beginning of the war in Iraq, partly for an eloquent speech that had him widely compared to Shakespeare's Henry V, and partly for his cigar-chewing Brandoesque good looks. Now he is being investigated for alleged war crimes: the Army is said to be looking into claims that Colonel Collins has breached the Geneva Convention in a number of ways, including by pistol-whipping an Iraqi civic leader.

If Colonel Collins turns out to have behaved less than impeccably, it would not be the first time that fine words and inspiring leadership went with rough deeds. Shakespeare understood that: he had Henry cry, “Let every soldier kill his prisoners,”—a line that most modern interpretations of the play omit.

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University funding

How nice, briefly, to be a Tory

May 22nd 2003
From The Economist print edition

A dangerous alliance against plans for reforming university funding

Get article background

THE Tories and the left of the Labour Party make strange bedfellows. They have, however, united—in the cause of embarrassing the government about its higher education policy.

The Tories' decision to oppose the government's plans for university top-up fees may be shameless opportunism, but it looks like successful shameless opportunism. Damian Green, the party's education spokesman says: “Never mind populism. It's just nice to be popular for once.”

Last week, the Tories announced that they would scrap the government's plans to raise university tuition fees in 2006 from their current, purely nominal, £1,100 a year to a maximum of £3,000, and make up the £700m or so forgone from fees by dropping the government's target of getting 50% into a university. Their new big idea is to give a “fair deal” to middle-income people feeling squeezed by higher taxes and charges—which, in this instance, means not allowing ideological consistency to get in the way of subsidising the middle classes. It's a far cry from liberating the universities, American-style, from state control, which they advocated at the last election.

Reuters

Clarke is all ears

This breathtaking cynicism wouldn't matter much were it not for the difficulties the government is having convincing its own MPs that increasing tuition fees is the most sensible way to solve universities' financial problems. There are 173, mostly Labour, signatories to a Commons motion deploring so-called top-up fees, which many see as a Blairite heresy against the party's traditional values. Although the government has said that nobody will pay fees upfront, Labour dissidents worry that the prospect of large debts will put poorer students off going to university.

In order to manage expectations, Labour whips tend to exaggerate the size of the rebellions they face. Even so, when the bill to reform university funding gets its first reading in the autumn or next spring, the revolt is likely to be much bigger than the 65-strong rebellion over foundation hospitals. On current numbers, the government could lose the vote.

There is plenty of time for deals to be done, but it is not obvious what the government can concede. The education secretary, Charles Clarke, has already been forced to promise a so-called “access regulator” to get more poor people into good universities, and to agree that fees should be capped until the next-parliament-but-one. Even if, as expected, Mr Clarke raises the £15,000 earning threshold above which student loans have to be repaid under his proposals, it won't cut much ice with his opponents.

But Mr Clarke may get a helping hand from an unexpected—and unwelcome—quarter. The rebels hate the idea of differential fees, which imply that smart universities might charge more than ex-polytechnics and therefore that those willing to pay more might get a better education than those who weren't.

They needn't have worried. Just about every university in the land appears to be planning to levy the full £3,000—a sure indication that the figure has been set too low. A competitive higher education sector thus looks as remote as ever.

The New Labour way is to be slightly brave. Unfortunately, it's also the way to combine maximum political opprobrium with rather modest effects.

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Asylum-seekers

Shock news: policy works

May 22nd 2003
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Numbers of asylum-seekers are falling sharply

FOUR years ago, Dover, the town at the British end of the Channel Tunnel, was flooded with asylum-seekers. Locals demonstrated, and protests exploded into fights between residents and asylum-seekers. Now, according to Gwyn Prosser, the local Labour MP, Dover's reception centre is so empty that asylum-seekers are being shipped in from other, more crowded, centres in Croydon and Birmingham.

The idea that asylum-seekers are an uncontrollable flood is beginning to look somewhat alarmist. Dover's experience is reflected in national figures. The number of applications in the first quarter of this year was a third lower than in the last quarter of 2002.

The main reason for the decline in asylum-seeker numbers is a series of measures taken in France as a result of pressure by the British government. The refugee camp at Sangatte, near Calais, which was a staging post for those wanting to get into Britain, was closed in December. Security around the tunnel entrance has been increased. Trains and lorries are now checked by both heartbeat detectors and body-heat scanners. All freight is searched. Britain now operates immigration controls in France, so anybody then declaring themselves to be an asylum-seeker is France's problem, not Britain's.

Might the clampdown around the Channel Tunnel displace hopeful migrants to other ports and Eurostar stations? Not if the national figures are to be believed. But, in case that should happen, security is being tightened at other Eurostar stations and Channel ports, such as Brussels, Zeebrugge and Ostend.

Life has been made touger for asylum-seekers in Britain, too. They now have to carry identity cards to be able to claim benefits. Failed asylum-seekers are being shipped back at a faster rate: 14,500 in 2002-03, a 24% increase on the previous year. The government is chartering its own planes: a weekly flight ships failed asylum-seekers back to Kosovo. “Word is getting out,” says the Home Office.

The main losers, other than the thousands of geographically and socially mobile people from poor countries who now find it harder to get into Britain, will be those making hay out of the problem. The British National Party did well at the local elections earlier this month on the back of worries about asylum-seekers. If this trend continues, its prospects will dim.

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Telecoms

2 bad for 3G

May 22nd 2003
From The Economist print edition

With mmO2 and 3, the story gets worse

FOUR of the five largest losses in European corporate history have come from telecom companies. The fifth largest came on May 21st from the bizarrely named mmO2, which used to be known as BT Cellnet, and is the mobile operation spun off from BT in 2001.

The causes of this red ink from telecoms are the same: writing off the many billions spent on other telecoms firms and on 3G licences from delighted governments at the height of the tech bubble. Of the £10.2 billion pre-tax loss announced by mmO2, almost £6 billion went in writing down the value of 3G licences in Britain and Germany. Although only about $20 billion has been knocked off the value of the $100 billion companies spent on licences, this is largely because Vodafone (the biggest buyer by far) and a few others have yet to come clean.

While admitting that telecoms firms had overpaid for 3G in Europe, Peter Erskine, the chief executive of mmO2, says that its European 3G licences are still worth some $6 billion. The experience of 3, a still more irritatingly named company, suggests that even this might be optimistic. 3 is a new mobile-phone company owned mostly by Hutchison Whampoa of Hong Kong, and in mid-March was the first in Britain to offer services that could be supplied only by 3G. That means videos. Other companies aim to use 3G only when they run out of capacity, and have dragged their feet in expensive 3G development.

The costs of being first have been huge. So far, Hutchison has spent £4.4 billion on a British licence, though it got almost £2 billion back from two other companies that invested in the venture—NTT DoCoMo, a Japanese mobile-phone company and KPN Mobile, a Dutch one. But to develop its network Hutchison has pumped in £1 billion of equity into 3, which has itself raised some £3.2 billion of debt. Including the cost of the licence, in other words, about £8.6 billion has been invested in 3 (though not all of it has been spent).

3 wants to sign up 1m users by the end of this year. But in its first 17 days, it signed up only 10,000 people—around a quarter of the number it needs. Some of those may return the phones, since they get their money back if they do so within 14 days. Technical problems have been rife: some calls disappear when users leave a 3G area. To spur demand, 3 has halved the price of the handsets, to £199. It has also replaced its boss.

3 will not release any more figures, saying only that it is “happy with the progress”. But it seems clear that nothing like enough people will want to watch a lot of tiny videos to justify the sort of huge sums that Hutchison has shelled out.

A further threat is the growth of wi-fi, a wireless networking technology that allows laptop users fast internet access in a discrete locality, such as a hotel or an airport lounge. Vodafone, in particular, has high hopes of selling 3G modems for mobile computing, but will find it tough to compete on price with the wi-fi providers.

The big profits are still in the unglamorous, slow-growing voice business, and seem destined to stay there. Phoning people, after all, is what people generally use phones for.

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British film industry

Disney-in-the-Dales

May 22nd 2003
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The government's policy on films, once daft, is now a bit more sensible

ALL the time-honoured film-industry traditions were on show at the Cannes Film Festival this week: frantic networking, the hyping of rubbish and grumbling about how there isn't enough subsidy from the British government. Ewan McGregor's complaint about government meanness towards his latest film, “Young Adam”, seems a bit rich, since it got £500,000 from the Film Council and, given what's happened to film subsidies, it's lucky to have got anything at all.

In the late 1990s, film policy was a disaster. Some £120m of lottery money went to the film industry through the Arts Council. That produced nothing watchable except “Billy Elliott”. Many films it invested in never got shown. In 2000, the budget was slashed, and responsibility handed over to the Film Council.

The Film Council spends a tiny £20m a year on film production, compared with an average cost of $80m, according to the Motion Picture Association of America, of a single Hollywood film, and with around *euro*200m of state support for French film-making a year. It has done better than its predecessor: although only around 30 of more than 200 projects it has put money into have turned into films, some have been big successes, notably “Gosford Park”. Robert Jones, head of the Premiere Fund, which invests in potentially commercial ventures, says that it now recoups well over 50% of the money it invests.

More importantly, though, the Film Council recognises that subsidies are not the whole answer. The council's new strategy also relies on encouraging foreign investment.

That's a sensible approach, not just in terms of creating jobs. These days, American studios' idea of British culture doesn't stop at the traditional corsets-and-men-in-tights variety. They are also colonising the sort of northern contemporary drama that used to be touted as the main justification for subsidising the industry.

Disney, that icon of Americana, for instance, has set up a production outfit, the UK Comedy Label, dedicated to what Daniel Battsek, its head, calls “high concept, low budget” British comedies. At Cannes, the division unveiled its latest feature, “Calendar Girls”, about the improbable efforts of a group of middle-aged Yorkshire Women's Institute members to raise money by posing naked for a calendar. Due for release later this year, it is expected to be a hit.

Last year, Britain lured £268m of inward investment into the film industry, up by 16% on 2001; and 19 foreign films were made in the country. The Film Council can take some credit: it lobbied the government, for instance, to stretch child-labour laws so that Warner Brothers' Harry Potter films could be made in Britain, using British child actors. Against this measure, the British-sounding films that get made in Britain, but with American money, do not represent a British failure to finance the transfer of their own stories on to the big screen as much as Britain's successful seduction of Hollywood.

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Bagehot

The ties that do bind

May 22nd 2003
From The Economist print edition

Tony Blair and Gordon Brown can't go on like this

THE BBC is currently airing a programme called “I'll Show Them Who's Boss”. In it, Gerry Robinson, the former chairman of Granada, pushes his nose into the affairs of a number of family-run firms. The common theme is that of complex and fractious relationships interfering with the interests of the business. The lesson Mr Robinson, a charming fellow but a ruthlessly clear thinker, draws each week is that these enterprises will fail unless there is some agreement about who is in charge. Of course, his advice is rarely taken. The insight of a rational outsider is the last thing any of those involved wants to hear.

Have Tony Blair and Gordon Brown reached a similar point in their relationship? If the open factional warfare that has broken out over the decision on whether to hold a referendum on joining the euro is anything to go by, it may be too late for any Robinson-style counselling. After a brief rapprochement in March, when the chancellor threw his weight behind behind the prime minister over Iraq, it has apparently been back to business as dysfunctionally normal. Only worse.

It was entirely predictable that, once the war was over, the euro would take centre stage, thanks to the government's self-imposed deadline to pronounce on the five tests by June. It was equally predictable that, in the run-up to what Mr Blair has foolishly described as the most important decision the government would take, the media would focus on the struggle between the chancellor and the prime minister over whether the prospect of holding a euro referendum can possibly be resurrected before the next election.

But although this has been played out in the newspapers and the television studios as high political drama, there has been something slightly contrived about the whole thing. One side characterises Mr Brown as the sturdy guardian of Britain's economic interest, protecting the nation from Mr Blair's besotted Europhilia. The other portrays Mr Brown's hostility to the euro as part of an unrelenting campaign to undermine Mr Blair until the prime minister finally decides to throw in the towel and hand over to Mr Brown.

None of this, naturally, comes from either Mr Brown or Mr Blair. Their camp-followers feed it to journalists who, in the absence of any real suspense over the actual decision, are grateful for anything to liven up the story. Certainly, there is some serious political arm-wrestling going on between the chancellor and the prime minister. But the deliberate exaggeration of the differences between the two men has reached a point at which it both poisons their already strained relationship and creates real peril for the government.

Both men understand the danger, but have no idea what to do about it. At the end of last week, they took the unusual step of issuing a joint declaration insisting that they were in complete agreement over the euro. The reaction was incredulous laughter. After Gordon Brown made a largely positive speech to the CBI this week about the need for an outward-looking and flexible Europe, the pro-euro camp, which has become increasingly hysterical ahead of the announcement on June 9th, accused him of adding a sixth and potentially insuperable economic test to the five existing ones.

While these attempts to calm things down have been ignored, a wild speech by Peter Mandelson, a former minister and confidant of Mr Blair, is taken seriously. He accused the chancellor of being “politically obsessed” and having “out-manoeuvred” the prime minister at “incalculable” cost to the country and the New Labour “project”. Never mind that Number 10 speedily, and in brutal terms, rubbished what Mr Mandelson had said: the effect was as if the words had been Mr Blair's own.

There are real tensions and disagreements over real issues between Mr Blair and Mr Brown. Yet deep down both men understand what their excitable supporters do not: there is no escape from their marriage. Were Mr Blair to push Mr Brown into quitting the government—say by threatening to move him to the Foreign Office—rather than finding himself liberated to do all the things he wants, he would face a rebellious rabble with Mr Brown at its head. Meanwhile, Mr Brown is these days in danger of becoming the champion of both the Labour left and the anti-European Tory press: a strange political base for the party's arch-moderniser.

Let's work together

Personal ambition apart, the truth is that the things that divide the prime minister and the chancellor are not nearly as great as their rival camps like to pretend. The notion that Mr Blair wants to push Britain into the euro regardless of the economic risks defies belief. The idea that Mr Brown is a driven Europhobe is just as implausible. They may not have quite the same view about the balance of risk of between staying out and going in, but in the short term Mr Blair has accepted that he is bound by the chancellor's judgment, and in the longer term both want to move on from the looming “not yet” verdict. This week the supposedly Eurosceptic chancellor said he looked forward to “uniting around a pro-European consensus”. But unless something changes, the chances of that are remote.

Dealing with each other is difficult, but not impossible. Their real problem is holding back their loyal but destructive followers. What Mr Blair and Mr Brown need is some kind of road map (to borrow a term from a different conflict) that clearly defines the things both men want to achieve and how they intend to work together for the next four or five years. And, above all, they must communicate it to their supporters and demonstrate their commitment to it by word and deed. After the last few days, they don't need Gerry Robinson to tell them that things can't go on like this.

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Executive pay

Have fat cats had their day?

May 22nd 2003 | LONDON AND NEW YORK
From The Economist print edition

Reuters

British and American shareholders have begun what looks increasingly like a sustained revolt against excessive executive pay

Get article background

OUTSIDE the QE2 conference centre in London, where GlaxoSmithKline (GSK) held its annual meeting on May 19th, there were activists protesting at the firm's drug-pricing policies in poor countries. Inside, two old ladies (one cosily covered in animal hair) complained, at some length, about the firm's treatment of beagles. Yet for most of GSK's shareholders this week, there was only one topic of real importance: the severance arrangements of the firm's gallic, magnificently haughty boss, Jean-Pierre “J-P” Garnier.

Those arrangements, estimated to be worth $35.7m to Mr Garnier should he depart prematurely, have put GSK in a bit of a spot. Under new rules, shareholders in Britain get to vote each year on their firm's executive-pay plans. GSK's shareholders promptly voted against management. This has left the firm's hapless board trying to balance shareholders' ire against its contractual obligations to Mr Garnier. The chairman, Sir Christopher Hogg, promised a full review of GSK's pay policies even as Mr Garnier was hinting that he and his lawyers might dig in.

It seems certain that the GSK vote will go down in history as a landmark in corporate governance. Some British activists think it may mark the moment when British capitalism decided to stop converging with its American counterpart—Mr Garnier's pay package was like that of a typical American boss, not a British one. It might also mark the moment when shareholders in British companies finally realised that they could not rely only on the separation of chairman and chief executive to keep management on its toes, and had to do the job themselves. But in this era of globalisation, a purely British conclusion may be too narrow—after all, over half of GSK's sales come from America and Mr Garnier spends more time in America than in Britain. The really striking fact is that the GSK vote is part of a determined new campaign by shareholders on both sides of the Atlantic to tackle how firms pay bosses.

This new assertiveness has several causes. In the wake of scandals and other corporate disasters in America and Europe—from Enron to Marconi—investors want evidence that boards have begun to take their duties to shareholders more seriously. In Britain, the National Association of Pension Funds has stiffened the resolve of its members. Spurred on by their GSK triumph, British activists may turn their attention to HSBC, Tesco and ICI. In America this year, investors submitted hundreds of shareholder resolutions for a vote at annual meetings, asking that management change executive-pay practices. For

the first time, many of these resolutions—which, as in Britain, are not binding on management—are being passed. Now, investors want to see evidence of the sort of spine in the boardroom that might have prevented the worst excesses of the late 1990s. Executive pay, says Bill Patterson, the head of corporate governance at AFL-CIO, a trade-union group, “has become the litmus test for corporate reform.”

There is an emerging consensus (except, it seems, in corporate boardrooms) that pay in the 1990s contributed to—and perhaps sometimes caused—undesirable or even destructive behaviour. Shareholders increasingly accept that the rot was not in a few bad apples but throughout the entire system—maybe including themselves. Even mutual funds, says Mr Patterson, which usually toady up to firms to protect corporate pension-fund business, have been voting against management on executive-pay issues this year.

Exhibit A is just the sort of severance arrangement that Mr Garnier's lawyers extracted from GSK's supine board. The boss's pay is meant to help align his interests with those of shareholders. Yet, in what has become standard practice, if in America more than Britain, GSK was proposing to heap lavish rewards on Mr Garnier in the event that it decided to sack him. A survey of firms in America's S&P 500 index by The Corporate Library, a watchdog website, found that, during 2001-02, American chief executives on average negotiated severance arrangements worth a stunning $16.5m apiece.

Taking the pulse

At best, such “golden parachutes” (along with golden handshakes, golden bungees and other happinesses) reward the boss merely for showing up and leaving: “pay for pulse”, as it has become known in America. Unsurprisingly, golden parachutes have become a particular focus of shareholder ire in America this year. At Tyco, Hewlett-Packard, United Technologies, Alcoa, Union Pacific, Raytheon, Verizon and Delta Air Lines, a majority of investors have voted in favour of resolutions asking firms to submit extra-generous severance deals to a shareholder vote.

American shareholders, in particular, are gunning for fixed-price share options (whose strike price is set at the then market price, and which are thus, unlike “performance-based” options, in the money as soon as a firm's share price begins to rise). They reckon that managers have boosted the short-term performance of their firm (fiddling the accounts to pull profits from the future, and so on), watched the share price climb, and cashed in their options, often leaving the firm a wreck.

This year, for the first time, TIAA-CREF, a big fund manager, has focused its governance efforts on curtailing the use of such options—as well as trying to get them properly accounted for—drawing up a list of 50-60 firms at which it thinks fixed-price options are being most abused. Of these, TIAA-CREF had words with 25 and filed resolutions at ten; seven of them were withdrawn after the firms “took steps”. The resolutions asked firms to use more performance-based options, so that bosses no longer get rewarded by a general rise in the stockmarket. They also asked that, once options are exercised, bosses be made to hold on to their shares for longer, encouraging a longer-term focus. At two firms—SBC Communications and Siebel—the matter came to a vote. TIAA-CREF's resolution won a respectable 35% of votes at SBC.

Because in both Britain and America such votes are not binding, cynics have predicted that the shareholder revolt will soon fizzle out. Do not bet on it. If shareholders judge that boards remain deaf to their worries, they may start to attack individual directors, especially those who sit on compensation committees (called remuneration committees in Britain). Some British institutions are agitating for a boardroom shake-up at GSK. Mr Patterson says that, if boards fail to act, AFL-CIO will start running campaigns against individual directors, pressing for their removal.

Other plans are afoot. Britain's Labour government may have dropped plans to outlaw excessive payoffs to departing directors, but it faces growing pressure to increase the ability of shareholders to control management. America's Securities and Exchange Commission has begun what, to bosses at least, must look like a worryingly open-ended inquiry into America's proxy-voting rules. Under consideration: whether to make shareholder resolutions binding, or even, horror of horrors, to allow shareholders to put forward their own candidates as board directors without an expensive “proxy contest”. The mere thought of an election in which there are more than hand-picked-by-the-boss candidates must surely be concentrating a few minds in the boardroom.

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Vaccines

Shot in the arm

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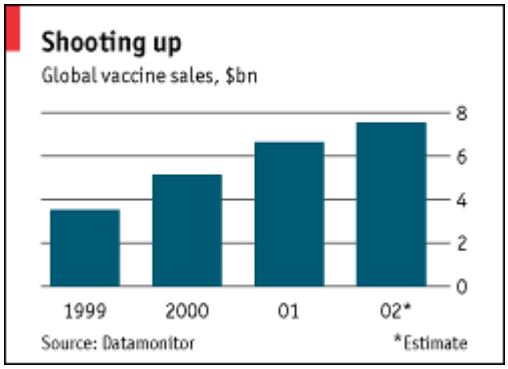
The vaccine business is booming

A DECADE ago, Paul Drayson was best known as the man who invented “Scooples”, a crispy bread that helped to make his fortune. This week, Mr Drayson's claim to fame is the sale of PowderJect, a British vaccines company he co-founded in 1993. Subject to shareholder approval, PowderJect will be acquired by Chiron, an American rival, for £542m ($890m), a whopping 31% premium over its average share price during the three months to the end of April.

Mr Drayson's move from basic biscuits to high-tech medicine is mirrored in the vaccine industry itself. In the 1980s, vaccines were the poor relations of pharmaceuticals—low-tech, low-margin products sold mainly to government agencies to help them fight childhood disease. But the same biotechnology which has transformed other drugmaking has also allowed vaccine-makers to combat new diseases and create higher-margin vaccines (such as for hepatitis B) for adult consumers willing to pay out of their own pockets.



Mother Nature is also giving vaccine-makers a boost. Ageing populations in the rich world are increasingly offered flu vaccines by governments keen to keep health-care bills low: together, Chiron and PowderJect become the second-biggest supplier in this $1 billion market. The emergence of novel infectious diseases also means new opportunities for vaccine firms: Chiron, for example, has already started work on a vaccine against SARS.

Fear of bioterrorism is also helping. Since 2000, Acambis, a British vaccine firm, has secured $771m in contracts from the American government to supply it with smallpox vaccine. PowderJect, for its part, won a £32m order from the British government to do the same, a deal subject to keen scrutiny since Mr Drayson is also a prominent contributor to the Labour party. After an official inquiry, the contract was deemed above board, and now Powderject is waiting to hear whether it has won another big government order. All in all, reckons Amber Gibson, an analyst with Datamonitor, global vaccine sales have more than doubled since 1999 and are likely to grow by around 10% a year on average until 2010.

That said, vaccine-making is an expensive, complicated and time-consuming business. It costs roughly $400m to bring a new product to market, and years of testing to ensure its safety. Even so, several vaccines have been withdrawn because of side-effects. Uncertainty about likely future demand, particularly in the case of bioterrorism, can be great, discouraging investment in innovation. Lingering controversies in some countries over links between, say, a combination vaccine for measles, mumps and rubella, and autism, excite public fears. Even though an industry-wide product-liability fund has been set up, in America the fear of lawsuits is constant. Manufacture can be tricky, and capacity in short supply. A big attraction of PowderJect to Chiron, aside from its research, is its manufacturing operations in Britain and Sweden.

No wonder vaccine-making is increasingly in the hands of big firms: between them, GlaxoSmithKline, Aventis Pasteur, Wyeth, Merck and the soon-to-be-enlarged Chiron control more than 80% of the market. PowderJect itself was the product of several mergers; will it be the last for its new owner?

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European takeovers

Reform's last gasp

May 22nd 2003 | PARIS
From The Economist print edition

Will the latest blocking of a takeover directive wreck the entire initiative?

EPA

Monti practises his brave face

EUROPEAN commissioners often have to put on a brave face. Part of their job is to cajole and charm national politicians into signing up to new Europe-wide projects or rules, and they do not always succeed. Pity then Frits Bolkestein, the commissioner in charge of the single market. On May 19th, his latest effort to introduce a directive on corporate takeovers was stymied by what amounted to pork-barrel politics. He put on a brave face, but must have been utterly dismayed. It is quite likely that the directive is dead. The effort to create it has lasted some 14 years.

The fate of the directive reveals the failings of Europe's business-reform programme. A previous directive almost became law in 2001, but fell at the final hurdle in the European parliament after the Germans withdrew their support. The Germans were back in opposition this time, joined by the Scandinavians and British. Officially, a decision on the directive is postponed. In reality, there is unlikely to be further progress.

What motivates the opposition? The Germans fear that they might lose control of their big industries. Vodafone's hostile takeover of Mannesmann in 2000 scared corporate Germany witless. Scandinavians dislike the directive's one-share-one-vote principle. That betrays the influence of family dynasties, such as Sweden's Wallenbergs, who rely on multiple voting rights to keep control of their empires. And there is also festering frustration directed at the Commission because it has several times intervened on competition grounds to stop the formation of Nordic champions, most notably in banking.

But why on earth was Britain among the blockers? Here is where the pork comes in. Britain is fighting hard against a directive that would give more rights to temporary workers. It sided with the Germans on takeovers in return for support on that other front. Ironically, on May 20th, Gordon Brown, Britain's chancellor, gave a speech in which he said that he wanted Britain to play a much bigger role in liberalising the European economy and encouraging competition. Mr Bolkestein might remind him of that next time he presents the takeover directive, if there is a next time.

Lawyers in Brussels admit to a growing, general unease about the future of the single-market project. Liberalisation of the energy market is still delayed, thanks mostly to French intransigence. Financial-services reform is stuttering. Yet the Commission seems reluctant to use its full powers to force the pace. It has had some successes—a recent court ruling against golden shares, for example—but these have had only a limited impact.

Another area where there is ongoing trouble is in merger control. To general approval late last year, Mario Monti, the competition commissioner, announced important procedural reforms after a series of decisions by his department suffered embarrassing rebuffs in court. Those reforms have not yet been implemented. Worse, a proposal for new merger guidelines proved so garbled in its central definitions that it had to be withdrawn. A replacement is expected in a few weeks.

The Commission's perceived weakness is encouraging bolder moves against it. Festival, an Italian cruise-ship operator, has issued proceedings aimed at overturning the merger of rivals Carnival and P&O Princess. The Commission approved the deal in February, but Festival says that the merger was not scrutinised properly.

General Electric (GE), a huge American conglomerate that was controversially frustrated in its effort to

merge with Honeywell in 2001, is also back in the fray. The Commission's decision to block the Honeywell deal is subject to appeal, although that is moving only slowly to court. But GE wants to buy Instrumentarium, a Finnish medical-equipment maker. After objections from Philips, a Dutch rival, the Commission began a review last month. It is too early to know whether another cross-border spat is looming, but perhaps Mr Monti should practise putting on his own brave face. Just in case.

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WorldCom

Crime pays

May 22nd 2003 | NEW YORK
From The Economist print edition

Yet more ways for shareholders to recoup their losses in America

Get article background

FOR the biggest fraud in accounting history, the biggest fine. On May 19th, MCI, formerly known as WorldCom, announced that it had agreed with the Securities and Exchange Commission to settle an investigation into its accounting for a staggering $1.51 billion. As the firm is in the bankruptcy court, the SEC will enter its claim along with WorldCom's other creditors, and will get only 30 cents or so on the dollar. Even so, the $500m that is bound for a new SEC “investor-restitution fund” is by far the biggest fine ever levied on a non-financial firm. The next biggest, $10m from Xerox, does not even come close.

Such a victory is handy for the SEC, which has been criticised for its supposed inaction after various accounting scandals. But the fine also draws attention to new rules, passed with the Sarbanes-Oxley act last year, which make it easier for shareholders to recover money from bankrupt firms. As this disturbs the ranking of creditors (which usually has shareholders, as the “residual-risk takers”, at the bottom of the heap) on which America's capital markets are built, the consequences of such a development are not yet fully understood.

Sarbanes-Oxley has made it far harder for firms to get private securities-fraud claims thrown out by the bankruptcy courts, as they used to do routinely. At a guess, says Rick Tilton, the boss of Greenacre Asset Advisors, a bankruptcy specialist, assorted lawsuits hanging over MCI may cost the reorganised firm $2 billion in payments to shareholders: a handsome settlement, but not big enough for the parasite to kill the host. Thus, together with the $500m that the SEC has extracted, shareholders could recover $2.5 billion. Other bankrupt firms, such as Enron and Adelphia, face a similar situation. This may please the crowd, but there is a cost: bank lenders and bond investors (especially those, like Mr Tilton, who specialise in distressed debt) may soon raise their prices.

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China's oil companies

Drilling for the Party

May 22nd 2003 | HONG KONG
From The Economist print edition

China wants more energy

THERE is today only one industry in which the Chinese are showing up all over the world as buyers: oil. This week, China National Petroleum Corporation (CNPC), the largest of China's three state-controlled producers—and better known under the name of its listed subsidiary, PetroChina—announced a deal in Sudan to double its output at a refinery there and to build a pipeline to a port. In April, CNPC increased its investments in Indonesia and got permission from Russia to build a pipeline from Siberia to China. This follows other recent deals in Venezuela, Peru, Canada, Thailand, Myanmar, Turkmenistan, Azerbaijan and Oman.

The other two Chinese producers are also busy. Last week, CNOOC, the smallest of the three but the main offshore producer, said that it will buy a stake in Australia's largest gas field. This follows a set-back last week in Kazakhstan's part of the Caspian Sea. Both CNOOC and China Petroleum & Chemical Corporation, also known as Sinopec, China's second-largest producer, had hoped to buy stakes from the current owner, Britain's BG Group, but were pre-empted by western heavyweights including Exxon Mobil, Royal Dutch/Shell, Eni and TotalFinaElf.

This Chinese buying spree owes much to the politics of China's industrialisation. The Communist Party deems it necessary to maintain GDP growth of at least 7% a year to avoid social unrest and assure its own survival. Disruptions such as that caused by the SARS outbreak only make it more paranoid. So the Party wants to secure adequate supplies of energy.

China's own reserves, most notably at its huge Daqing oil field in the north-east, are slowly running out. Since 1993, when China became a net importer, its reliance on foreign oil has increased steadily. The International Energy Agency estimates that net imports could triple during this decade to more than 4m barrels a day. Moreover, over half of China's imports currently come from the Middle East and seem, in Beijing, worryingly exposed to the whims of China's biggest potential strategic rival, America. Hence the urgency of diversifying to other sources of supply.

Each of the three firms under the government's control has spun off a subsidiary and listed some of the shares—between 10% and 30%—on stock exchanges in Hong Kong and New York. Alongside those in China's telecoms operators, these shares have become international bellwethers for the Chinese market as a whole. In April, it became known that Warren Buffett, a revered American investor who usually avoids emerging markets, has built up a stake in PetroChina.

The success of these listed firms—and thus the proper treatment of their minority shareholders—is itself part of government strategy. China wants to complete its transition from a planned to a market economy, and thus feels it must prove that it can turn rusty state-owned enterprises into modern, competitive companies. Both PetroChina and Sinopec used to be welfare organisations that operated schools, housing, hospitals and playgrounds for their staff, in addition to refineries. (CNOOC, which is younger and has few assets on dry land, had an easier start.) These remnants of Maoism were carefully separated from the listed firms. Nonetheless, all three constantly have to assuage investor concerns that political pressures could override shareholder value.

Minority shareholders are certain to pay close attention to the terms on which the three firms conduct their buying sprees, including the extent to which transactions by the parents are ring-fenced from the listed subsidiaries, and whether the prices are appropriate. A more fundamental debate over strategy is also overdue. China's rulers, weaned on dogmas of self-sufficiency, assume that owning overseas assets is safer than buying from world markets at prices that fluctuate, says Arthur Kroeber, an editor at the *China Economic Quarterly*, a research publication. In time, they may discover that running pipelines in

exotic places can be just as risky.

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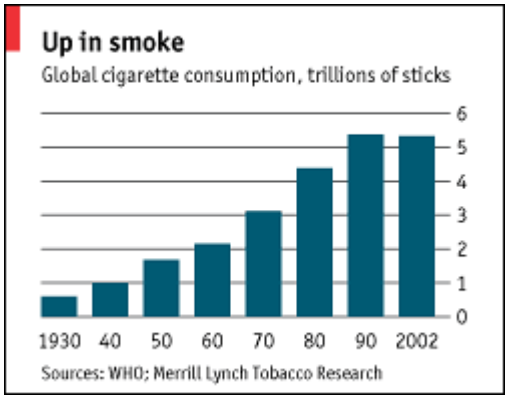
Cigarettes

Puffed up or stubbed out?

May 22nd 2003
From The Economist print edition

Good news and bad for Big Tobacco



FOR Big Tobacco May 21st brought mixed news—although, as rising share prices confirmed, the good news far outweighed the bad. The merchants of death celebrated after a Florida appeals court overturned an earlier judgment awarding $145 billion to plaintiffs in a class action suit against five tobacco firms. The court dismissed the class, saying that its sheer variety of complaints made it unsuitable for such treatment.

Earlier, the 192 member states of the World Health Organisation voted unanimously to pass the Framework Convention on Tobacco Control, the first international treaty to clamp down on tobacco consumption. Among its many measures, the new treaty obliges governments to prohibit advertising, as far as their constitutions permit, as well as requiring at least 30% of any tobacco product's packaging to be given over to health warnings. It also encourages countries to set cigarette taxes at a level that will discourage smoking.

Industry analysts are divided as to the treaty's likely effect on Big Tobacco. Martin Feldman at Merrill Lynch believes that, if enough developing countries (which now account for roughly 75% of the world's cigarette market) choose to enforce the treaty strongly, then cigarette consumption will eventually falter as it has done in the rich world. But Jonathan Fell, at Morgan Stanley, says that gradual and uneven implementation means that it may be a long time, if ever, before the treaty affects the leading firms—though it may eventually drive smaller players to the wall if the advertising ban deprives them of the, er, oxygen of publicity.

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Low-cost airlines

Cheap and cheerful

May 22nd 2003
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Despite aviation's worst slump, the world is full of new airlines

Get article background

IN LATE October, a new airline, Air Arabia, will start flights from Sharjah in the United Arab Emirates; its principal destinations will include Baghdad and Tehran. It will start with only a couple of leased Airbuses, but has big ideas about becoming the Middle Eastern equivalent of easyJet, the leading European low-cost carrier (LCC). The essence of the easyJet low-cost model is frequent flights to mainstream airports. In this way, it appeals to cost-conscious business travellers as well as bargain-hunting leisure travellers.

Air Arabia is no solitary venture. No fewer than 15 airline entrepreneurs want permission to start airlines in Iraq itself. Starting a new airline anywhere might seem crazy when the industry is losing billions—even easyJet lost £48m ($76m) in its latest half-year. But numerous new airlines are also taking off in Europe and Asia. According to Keith McMullan of Aviation Economics, a London consultancy, there are two main reasons: cheap assets and profitable role models to follow.

With about 1,800 unwanted planes parked in the Arizona desert, aircraft are cheap. Airbus narrow-body A320s, ideal for low-cost carriers, are in plentiful supply as the European manufacturer has not cut production, unlike Boeing. So A320s are available for only about $150,000 a month, compared with $350,000 normally. But the role models are equally important. “Europeans have seen the success of a handful of LCCs in America, led by Southwest Airlines, JetBlue and AirTran,” says Chris Avery of J.P. Morgan. “There is a window of opportunity for newcomers before Ryanair and easyJet become so big they cannot be challenged.”

Despite an intensely competitive market, German tour operators are moving into low-cost airlines. Michael Frenzel, chief executive of TUI, Europe's biggest holiday company, boasted to the World Travel and Tourism Council's conference last week that his LCC, called Hapag-Lloyd Express, has doubled its fleet and hopes to carry 2m passengers this year. He, perhaps unwisely, is not worried that his LCC will cannibalise TUI's traditional charter-package business, already hit by weak bookings and reporting heavy losses this week.

The LCC phenomenon has also spread to Asia. Virgin Blue (part-owned by Sir Richard Branson) has won 30% of the Australian market since it launched in 2000, and is planning to start serving Pacific islands such as Fiji. Air Asia is also considering expanding from its Malaysian domestic market. The region has other new LCC carriers such as Air Mekong in Cambodia, Air Paradise in Bali, and even Air New Zealand, which has re-emerged from near-bankruptcy as an LCC.

As these carriers fly longer distances than their European counterparts they could show the limits of the LCC model. LCCs' cost edge comes from cheap, flexible labour and fast turn-arounds at airports. But the longer the flight, the more that costs such as fuel matter. Aircraft also take longer to clean up and turn round after an eight-hour flight. Airlines such as Laker Airways in the 1980s and CityBird in the late 1990s tried to combine long-haul and low-cost and failed. But, with Southwest and JetBlue thriving flying coast-to-coast in America, that may not be inevitable.

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Selling the BBC abroad

No sex please, we're American

May 22nd 2003
From The Economist print edition

The Beeb's strange commercial triumph

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NANNY to British broadcasting and guardian of upmarket TV, the BBC was last week celebrating the sale of raunchy entertainment to America. At the “upfront” market, when the networks unveil their autumn schedules to advertisers, NBC said that it had snapped up “Coupling”, a BBC series made by Hartswood Films, an independent producer, and a possible replacement for NBC's outgoing comedy, “Friends”. In the “Coupling” pilot, based on BBC scripts but recast and set in Chicago, one couple has sex in a lavatory, and one actor wisecracks that “one swallow does not a girlfriend make.”

The BBC regards this achievement with a mix of pride and bafflement. When BBC America, a cable channel, was launched five years ago, says Rupert Gavin, head of BBC Worldwide, the corporation's commercial arm, “they used to just say ‘bring us Monty Python and posh girls in frocks'.” Today, the BBC's surprise American hits are not only steamy drama such as “Coupling”, but the middle-market reality series and formats—home decoration (“Trading Spaces”), gardening (“Ground Force”), fashion (“What Not to Wear”)—for which the BBC is so chastised at home.

This trend raises an awkward issue, however. BBC Worldwide, a fully owned subsidiary, grew up on the back of magazine publishing, particularly the *Radio Times*. Although the BBC is still Britain's third-biggest consumer publisher, the business now spreads into TV sales, music, DVDs, toys, video games and the like. Worldwide's job is to make money from BBC properties that can be ploughed back into programme-making for the benefit of the British licence-fee payer. With a treasure chest of famous brands, plus an archive library, that sounds simple enough.

But the Beeb is constrained in a way that its purely commercial rivals—from Disney to Viacom—are not. Worldwide is not supposed to use a cross-subsidy from the licence fee to compete unfairly. So every decision is subject to scrutiny by squads of in-house lawyers and “fair trade” monitors. The effort to observe the rules can be clumsy. In the late 1990s, for instance, the BBC set up beeb.com, an internet site that was meant to make money and stand alone from the BBC'S (free) website. Nobody else understood the distinction. Last year, beeb.com was shut down.

Short of privatising the BBC, which is not on the political agenda at least before the renewal of its charter in 2006, this organisational separation is probably the best way for the Beeb to generate commercial income. It certainly does a better job of exploiting this system than it used to. In the year to March 2002, BBC Worldwide's sales reached £660m ($946m), up by 61% from 1998, and it returned £106m to the BBC, a 41% increase. The BBC's TV sales, worth £172m, are still tiny compared with those of its global rivals. Disney alone probably sells about $1 billion of TV programmes a year outside America. Those who know Worldwide well say that its sales team is not particularly aggressive. Yet the BBC's TV exports were up by 15% in the year to March 2002, helped by the global roll-out of BBC branded cable and satellite channels. Half of Worldwide's revenue now comes from international sales, up from a third five years ago.

The more that BBC Worldwide exports globally, however, the trickier its relationship with the BBC's public-service arm could become. Worldwide is supposed to be chiefly a glorified sales house, marketing content dreamt up by free-thinking public-service spirits. Any other media conglomerate that was making, say, a new pre-school children's TV series, would first build merchandising revenue into the business model. In theory, the

BBC is not supposed to let such naked commercial motives influence its commissioning decisions. It is meant to work backwards and discover, miraculously, that the educational new pre-school series it has just devised—its latest is “The Fimbles” (pictured)—can be transformed into soft toys, games and DVDs, and exported. Commercial rivals say this claim to be above commercial motivation is preposterous: “I guarantee that their ability to sell marketable stuff makes them more likely to commission those sorts of programmes,” says one executive at Viacom's Nickelodeon.

Available, by chance, at a toyshop near you

Mr Gavin insists that the tension between the commercial and public-service impulses has not led to editorial compromise. “The Blue Planet”, for instance, a co-production with Discovery Communications, an American media group, is regarded as a successful blend of quality and marketability. The BBC is simply “turning British shows into American hits”, as a publicity sign in the entrance to Worldwide's London HQ puts it—and strictly in that order. As for accusations of over-commercialisation, Mr Gavin sees the issue as one of brand protection: he would not launch a lads' mag or a porn channel, nor even endorse a garden fork with a BBC gardening show. But a soft Fimbles toy, with a high “cuddle value”, he says, brings a character to life and enhances the brand.

The limit of acceptable commercialisation, though, is hard to define. The BBC happily marketed dolls from its children's series “Tweenies” at McDonald's, a move that some considered (God forbid) Disneyfication. The BBC insists that its recent success exporting middlebrow entertainment will not change the way it commissions programmes: blame British taste, not American, for such stuff. Just imagine, though, what the Beeb might achieve were it freed from the shackles of public ownership to make and sell what it liked. Then the Magic Kingdom might really quake.

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Face value

The ponytail versus the penguin

May 22nd 2003
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Does Sun's Jonathan Schwartz have a better strategy than Microsoft's for surviving the threat of free software?

HOW can you compete with something given away free? That has been the question dogging big software firms, above all Microsoft, ever since free ("open-source") programs made it into the mainstream—notably Linux, which is now a serious rival to costly proprietary operating systems such as Microsoft's Windows. It has also been the chief headache for Jonathan Schwartz since Sun Microsystems put him in charge of its software business a year ago. Although there has long been speculation that Linux might one day kill Windows, Sun has always seemed a more plausible, and imminent, victim of free software. But the Silicon Valley firm is now fighting back: a new approach, the product of Mr Schwartz's labours, was unveiled on May 19th.

Aged 37 and pony-tailed, Mr Schwartz might easily be mistaken for a hacker, or even for one of the Young Turks who developed Linux just for the hell of it—though he also shares the aggression and feistiness for which his boss, Scott McNealy, is well known. He joined Sun in 1996 when it bought his software firm, Lighthouse Design. After that, he was the driving force behind the Liberty Alliance, an industry group developing a rival method to Microsoft Passport for securely and easily moving personal details around the internet. Seasoned observers of the industry are impressed by his grasp of the complicated beast that is software. But will even that be enough?

Ironically, for Sun, in contrast to Microsoft, Linux has been less a software than a hardware challenge. Yes, the program is free—but many firms use it mainly because it allows them to buy cheap servers powered by Intel chips rather than more expensive Sun boxes. Since Sun's flagship Solaris operating system and Linux are both a variant of Unix, an operating-system standard, many applications written for the former can be easily converted to run on the latter. The result is that Sun is rapidly losing market share to makers of Intel-based servers, mainly Dell.

At first, Sun dismissed this threat. Then it tried to embrace Linux—offering its own cheap Intel-based servers running the free operating system. (Mr McNealy even dressed up as a penguin, the Linux mascot, at Sun's 2002 analyst meeting.) Yet the new computers were poorly received. Potential customers doubted that Sun was really serious about Intel-based machines.

So what is Mr Schwartz's new strategy? In San Francisco this week, Sun unveiled two new low-priced servers based on Intel chips. It also revealed that Oracle had agreed to make its software work on these machines—adding to speculation that Oracle is about to buy Sun. But much more significant was a subtle but crucial shift in the firm's Linux strategy: as well as Linux, Sun will now also push an Intel-compatible version of Solaris.

Mr Schwartz may seem to want to have it both ways. But he is trying to capitalise on an important trend. Some software users have started to realise that even Linux is not as free as it appears: for instance, it has to be maintained and upgraded. "Linux is like a puppy—in the beginning it's great, but you also have to take care of it," says Mr Schwartz. He hopes that firms will opt for Solaris, because it requires less care.

Simply put, Mr Schwartz wants to give customers a choice. On the one hand, he will offer them an open-

source solution, which lets them tinker and benefit from the collective brain power of volunteer developers. On the other, he will offer a proprietary option for customers worried about operational costs.

Contrast this with how Sun's arch rival is dealing with the Linux threat. Microsoft executives no longer call open source a “cancer” and a “destroyer of intellectual property”, at least in public. But, if anything, the firm has become more aggressive in competing with Linux. Last week, Microsoft was reported to have set up a special fund to pay for deep discounts on sales of Windows, to stop governments switching to Linux. “Under NO circumstances lose against Linux,” demanded an internal e-mail.

Restless in Redmond

Microsoft has also, indirectly, aided a lawsuit that could hurt Linux. On May 19th, it said that it had licensed the rights to Unix technologies from SCO Group, a small software firm. Earlier this year, SCO sued IBM, which has made a big commitment to Linux, seeking damages of at least $1 billion for allegedly sharing its Unix intellectual property with the Linux community. SCO also sent a letter to 1,500 of the world's largest firms, saying that they could be liable for their use of Linux. The lawsuit had seemed to be a ham-fisted attempt by SCO to get itself bought, or bought off, by Big Blue. But the deal with Microsoft lends credence to SCO's claims and helps it financially to press them. If the case (in which, ironically, SCO is represented by David Boies, who led the antitrust action against Microsoft) drags on, it is likely to discourage a growing number of firms from using Linux.

So which approach is more promising? It is unlikely that discounts and spreading “fear, uncertainty and doubt” (or FUD in geek-speak) will stop Linux—as long as customers see it as a viable alternative to Windows. Yet with its $46 billion in cash and its near monopoly on desktop PCs, where Linux has made little headway, Microsoft seems safe, however daft its Linux strategy. (Assuming that trustbusters let the firm follow it—the discounts may violate antitrust law, in Europe if not in America.)

Conversely, Sun may not have the time to see whether its way of dealing with Linux works, at least for itself. Such is the perceived threat of commoditisation to its franchise that it is increasingly seen as a possible takeover target, with Cisco and IBM, as well as Oracle, mentioned as possible buyers.

Whatever Sun's fate, Mr Schwartz is probably right that the software industry will not be taken over by free programs, as some geeks would like. The main attraction of open source, as he says, is the fact that it is “great for innovation”, not its questionable claim to be free.

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The beauty business

Pots of promise

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An industry driven by sexual instinct will always thrive

MEDIEVAL noblewomen swallowed arsenic and dabbed on bats' blood to improve their complexions; 18th-century Americans prized the warm urine of young boys to erase their freckles; Victorian ladies removed their ribs to give themselves a wasp waist. The desire to be beautiful is as old as civilisation, as is the pain that it can cause. In his autobiography, Charles Darwin noted a “universal passion for adornment”, often involving “wonderfully great” suffering.

The pain has not stopped the passion from creating a $160 billion-a-year global industry, encompassing make-up, skin and hair care, fragrances, cosmetic surgery, health clubs and diet pills. Americans spend more each year on beauty than they do on education. Such spending is not mere vanity. Being pretty—or just not ugly—confers enormous genetic and social advantages. Attractive people (both men and women) are judged to be more intelligent and better in bed; they earn more, and they are more likely to marry.

Beauty matters most, though, for reproductive success. A study by David Buss, an American scientist, logged the mating preferences of more than 10,000 people across 37 cultures. It found that a woman's physical attractiveness came top or near top of every man's list. Nancy Etcoff, a psychologist and author of “Survival of the Prettiest”, argues that “good looks are a woman's most fungible asset, exchangeable for social position, money, even love. But, dependent on a body that ages, it is an asset that a woman uses or loses.”

Beauty is something that we recognise instinctively. A baby of three months will smile longer at a face judged by adults to be “attractive”. Such beauty signals health and fertility. Long lustrous hair has always been a sign of good health; mascara makes eyes look bigger and younger; blusher and red lipstick mimic signs of sexual arousal. Whatever the culture, relatively light and flawless skin is seen as a testament to both youth and health: partly because skin permanently darkens after pregnancy; partly because light skin makes it harder to hide illness. This has spawned a huge range of creams to treat skin in various ways.

Then again, a curvy body, with big breasts and a waist-to-hip ratio of less than 0.8—Barbie's is 0.54—

shows an ideal stage of readiness for conception. Plastic surgery to pad breasts or lift buttocks serves to make a woman look as though she was in her late teens or early 20s: the perfect mate. “Mimicry is the goal of the beauty industry,” says Ms Etcoff.

Basic instinct keeps the beauty industry powerful. In medieval times, recipes for homemade cosmetics were kept in the kitchen right beside those used to feed the family. But it was not until the start of the 20th century, when mass production coincided with mass exposure to an idealised standard of beauty (through photography, magazines and movies) that the industry first took off.

From small roots to big business

In 1909, Eugène Schueller founded the French Harmless Hair Colouring Co, which later became L'Oréal—today's industry leader. Two years later, Paul Beiersdorf, a Hamburg pharmacist, developed the first cream to bind oil and water. Today, it sells in 150 countries as Nivea, the biggest personal-care brand in the world. Around the same time, in Tokyo's upmarket Ginza, Arinobu Fukuhara hit on eudermine lotion—the first Japanese cosmetic based on a scientific formula, and the first product for the Shiseido company.

But it was the great rivalry between two women in America that made the industry what it is today. Elizabeth Arden opened the first modern beauty salon in 1910, followed a few years later by Helena Rubinstein, a Polish immigrant. The two took cosmetics out of household pots and pans and into the modern era. Both thought beauty and health were interlinked. They combined facials with diets and exercise classes in a holistic approach that the industry is now returning to.

Rubinstein considered facelifts (via leather straps and electricity) to be as acceptable as lipstick, while Arden pioneered beauty branding, with her iconic gold and pink packaging. The two women, together with Max Factor (which originally produced make-up for actresses), built the foundations of modern marketing, bewitching consumers with aggressive tactics such as celebrity endorsements and magazine advertorials. In the 1930s they were joined by Revlon, and after the second world war by Estée Lauder. All these companies are still around.

The emerging beauty industry played on the fear of looking ugly as much as on the pleasure of looking beautiful, drawing on the new science of psychology to convince women that an inferiority complex could be cured by a dab of lipstick. Even then, ruthlessness and outright quackery lurked behind the façade. On launching her famous eight-hour cream, developed for her horses, Arden quipped: “I judge a woman and a horse by the same criteria: legs, head and rear end.”

Anything but skin-deep

Analysts at Goldman Sachs estimate that the global beauty industry—consisting of skin care worth $24 billion; make-up, $18 billion; $38 billion of hair-care products; and $15 billion of perfumes—is growing at up to 7% a year, more than twice the rate of the developed world's GDP. The sector's market leader, L'Oréal, has had compound annual profits growth of 14% for 13 years. Sales of Beiersdorf's Nivea have grown at 14% a year over the same period.

This growth is being driven by richer, ageing baby-boomers and increased discretionary income in the West, and by the growing middle classes in developing countries. China, Russia and South Korea are turning into huge markets. In India, sales of anti-ageing creams are growing by 40% a year, while Brazil has more “Avon Ladies” (900,000) than it has men and women in its army and navy. Although the industry's customers are predominantly women, it is increasingly marketing itself to men too.

The juicy returns are attracting new entrants. The household-goods giants Unilever and Procter & Gamble (P&G), facing maturity in many of their traditional businesses, are devoting more resources to their beauty divisions—as evidenced by P&G's current $6.5 billion offer for Germany's Wella, a hair-care company, to bolster its earlier purchase of Clairol, a hair-dye business. Simon Clift, marketing head of Unilever's personal-care businesses (including its big Dove and Sunsilk brands), says: “We are a Cinderella, seen as a soap-powder company, but we have changed our belief about what we do well.”

And so to bed

Most luxury-goods groups now have perfume brands, and many (like Dior, Chanel and Yves St Laurent) are selling make-up and creams too. LVMH, the biggest luxury-goods group of all, has moved into retailing with its Bliss spas and Sephora shops (which sell make-up).

At the same time the industry is consolidating. Many innovative younger brands have been swallowed up by the giants. Japan's Kao bought John Frieda to tap into the hair-dye business, one of the fastest-growing segments of the market. And in the past five years, LVMH has bought Hard Candy and Urban Decay, two funky young make-up brands; while Estée Lauder has acquired Stila, MAC and Bobbi Brown, another collection of up-and-coming names in make-up.

Since this burst of transactions, six multinationals account for 80% of American make-up sales, while eight brands control 70% of the skin-care market. With its Nivea brand, Beiersdorf is one of the few large independents left, desired by everyone from P&G and Unilever to L'Oréal.

Science fictions

Unable to outspend their big new rivals, the traditional beauty companies are trying to out-innovate them, by making even more of their scientific credentials. The industry is marketing a new category of products that blurs the line between cosmetics and non-prescription drugs—so called “cosmaceuticals”. L'Oréal's advertisements now stress how many product patents it has filed.

The focus on science has led to some genuinely new ideas, such as face cloths impregnated with cleansers that combine surfactant and paper technology. As yet, though, most of it is pseudo-science. Shiseido's recent international launch of its new Body Creator skin gel claims that its fat-burning pepper and grapefruit oil can melt 1.1kg of body fat in a month without any need to diet or exercise. At last year's launch in Japan, customers bought a bottle every 3.75 seconds.

Avon's chief executive, Andrea Jung, expects Cellu-Sculpt, a new cream that claims to take an inch off your thighs in four weeks, to sell three times as much as an ordinary body cream in its first six weeks. P&G is also playing the game. It is busy plugging the science behind its newest cream, Olay Regenerist, and it has built Pantene into the world's biggest hair-care brand on the basis of its “pro-vitamin B” ingredient. But a report by Britain's *Which?* magazine recently pointed out that vitamins need to be ingested to work, and that a Pantene shampoo it tested was no better than a supermarket's own brand.

That is hardly surprising: Jacques-Franck Dossin, an analyst at Goldman Sachs, says that beauty firms spend just 2-3% of their sales on research & development—compared with 15% by the pharmaceuticals industry. On the other hand, they spend a whopping 20-25% on advertising and promotion. Some of that money has been well spent. L'Oréal's “Because I'm worth it” tag-line has long been a huge success. And new companies like Pout are attracting attention with lipsticks labelled “Lick my lolly” and “Bite my cherry”.

Nevertheless, marketing is becoming hugely expensive, putting pressure on margins. Goldman's Mr Dossin worries that, in response to intensifying competition and consolidation, L'Oréal has recently

cranked up its spending on marketing, forcing an advertising war with rivals that will end up undermining everyone's profitability. Scott Beattie, Elizabeth Arden's boss, says that its marketing budget, which grew by 25% in 2002, will rise by another 40% this year. Avon plans to hike its advertising budget by 50%.

This competition has left some exhausted. Revlon, once one of the biggest make-up brands, has been tottering on the edge of bankruptcy. Its current boss, Jack Stahl, a former president of Coca-Cola, is fighting to get the business back on track. Unilever, which is facing slowing growth overall, is stranded in no-man's-land. It sold the great Elizabeth Arden brand and missed out on the boom in hair colour. Critics say it should now sell its remaining beauty business to a more focused group, such as Elizabeth Arden. Meanwhile P&G, seen as the first serious threat to L'Oréal for decades, is struggling with its $5 billion acquisition of Clairol. It has been losing market share at an alarming rate to both the French and to Kao's John Frieda.

Changes in distribution are also helping to separate the winners from the losers. The only real growth is coming through huge grocery chains such as Wal-Mart that want to deal with just a handful of big suppliers. That is good news for P&G and L'Oréal (which already gains two-thirds of its revenues from mass retailers). But Estée Lauder and Revlon are more dependent on unfashionable department stores where sales are declining and selling costs are high. Estée Lauder's chief executive, Fred Langhammer, bravely preaches the virtues of department stores: “People will always need advice about what skin cream to use,” he says. But he is wisely hedging his bets by buying fun specialist retailers, such as MAC.

Body rebuilding and refitting

Two potentially lucrative markets are being all but ignored by the traditional beauty companies. The first is cosmetic surgery, already a $20 billion business, which has been growing and innovating by leaps and bounds. The number of cosmetic procedures have increased in America by over 220% since 1997. Old favourites, such as liposuction, breast implants and nose jobs, are being overtaken by botox injections to freeze the facial muscles that cause wrinkles. With the number of these up by more than 2,400% since 1997, botox injections have become the most common procedure of all.

The newest lines are bottom implants, fat inserts to plump up ageing hands, and fillers like Restylane and Perlane for facial wrinkles. Cosmetic dentistry is also a booming business. Jeff Golub, Manhattan dentist to stars like Kim Catrall of “Sex and the City”, dubs himself a “smile designer”. “We are able to create all sorts of illusions,” he says. “The smile has become a fashion statement.” Tooth whitening is the botox of the cosmetic dentistry business.

What used to be the preserve of actresses and celebrities has become safer and more affordable. Alan Matarasso, one of America's leading plastic surgeons, says: “Ten years ago you could reconstruct a woman's breasts for $12,000—now it can be done for $600.” Drooping prices have helped cosmetic surgery to move into the mainstream. More than 70% of those who come under the knife now earn less than $50,000 a year.

The second big new market is in “well-being”—whole treatment systems that cover beauty, exercise and diet, including visits to spas, salons and clubs, and hark back to the early days of Mesdames Arden and Rubinstein. People are increasingly seeking natural cures rather than turning to chemicals, and an emphasis on being fit—not just thin—is growing in popularity. The trend is being led by a list of celebrities. Avon's boss, Andrea Jung, says modern beauty has been “redefined as health, self esteem and empowerment.”

Beauty firms are falling over themselves to sell products with new-age promise—Arden has a range of products called “Happy”, Avon sells diet bars, and L'Oréal owns a few spas. However, it has been left largely to entrepreneurs like American cosmetic surgeon Stephen Greenberg to offer real innovations. His “extreme make-overs” combine cosmetic surgery, a personal trainer for your body, and an image consultant for your face and hair. The traditional beauty companies have yet to grasp the opportunities in these rapidly growing and fragmented markets.

A slap in the face?

At the same time, the beauty business needs to guard against a growing consumer backlash. Like those facing the tobacco and food industries, this has two elements. The first concerns truth in advertising.

Creams and cosmetics are making increasingly extravagant marketing claims. So far, women have been willing to buy into the illusion. Should that change (and there are signs it might), then manufacturers expose themselves to potentially ruinous litigation.

Second, there is a moral dimension. The beauty industry is at a stage where it can permanently change a person's looks. Given advances in genetic engineering and the competitive drive, a race for beauty is conceivable in which people will strive to model themselves on some form of idealised human being. By selling the weapons to win this war, the industry may find itself roundly condemned and subject to legislation.

Public handwringing is already evident in the case of teenagers indulging in cosmetic surgery. In “Branded”, a book on marketing to teenagers, Alissa Quart notes that in America the number of teenage breast implants and liposuctions rose by 562% between 1994 and 2001. There is a cynical marketing phrase for all this: helping “kids look older younger”. A number of new books have begun to question the ethics of marketing beauty products and services to adults too.

Part of the backlash so far is tighter regulation. Europe recently passed new labelling and animal-testing laws on cosmetics and will soon give the public the right to probe how firms create cosmetics. This is sure to raise costs for the industry worldwide. Much of the concern, however, is misdirected. Compared with the lead or belladonna that once gave women gothic dreamy eyes, today's lotions are relatively harmless, and consumers are well informed. Cosmetic-surgery techniques are improving—liposuction using electrically vibrating rods, not manual jabbing, still sounds horrible, but it is safer. Worries about newish procedures such as botox look overdone too—the stuff has been around for a decade as a medical treatment. Even silicone breast implants may be back on the market soon, after improvements in technology.

The fact is that neither moral censure nor fears about safety will stop people from wanting to look better. The desire is too entrenched. An 18th-century British law proposing to allow husbands to annul marriages to wives who had trapped them with “scents, paints, artificial teeth, false hair and iron stays”, had no effect on women, who continued to clamour for the latest French skin creams. During the second world war, the American government had to reverse a decision to remove lipstick from its list of essential commodities in order to prevent a rebellion by female war workers. The beauty business—the selling of “hope in a jar”, as Charles Revson, the founder of Revlon, once called it—is as permanent as its effects are ephemeral.

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About sponsorship

Japanese banks

Rainy day for Resona

May 22nd 2003 | TOKYO
From The Economist print edition

AFP

The rescue of Japan's fifth-biggest bank may be a sign of even worse trouble ahead

Get article background

ON MAY 17th, Resona, Japan's fifth-largest bank, admitted that its capital-adequacy ratio (ie, its capital divided by its assets, weighted by risk) had fallen to around 2%, half the required minimum for domestic banks. That evening, Junichiro Koizumi, the prime minister, agreed to inject public money into the bank in order to prevent its collapse. Resona, which by early July will receive some ¥2 trillion ($17 billion) in return for new shares, will in effect be nationalised: the government will own more than half of its equity.

Resona—created only in March by the merger of Asahi Bank and Daiwa Bank, troubled recipients of ¥1 trillion of public cash between them a few years ago—was known to be in a bad way, even by Japanese standards. Nevertheless, its cry for help caught the government off guard. A few weeks earlier, the bank had reported a capital-adequacy ratio of 6%.

So what went wrong? Remarkably for Japan, where accountants are notoriously chummy with their clients, the bank's auditors were not convinced by its figures. Like many Japanese banks, Resona counted a large lump of “deferred tax assets” in its capital base. These assets—created when a bank makes losses, for example by writing off bad loans—materialise only if a bank makes enough taxable profit within the next five years to recoup the losses. In late April, one of Resona's two auditors, Asahi & Co, disputed the bank's rosy profit forecasts and quit. The forecasts would have enabled Resona to include ¥700 billion of deferred tax assets in its tier-one capital, making up 70% of the total, in its accounts for the year to March 31st. The other auditor, Shin Nihon, Japan's largest accounting firm, got cold feet shortly afterwards, and refused to put its name to the accounts unless Resona cut its deferred tax assets by 40%.

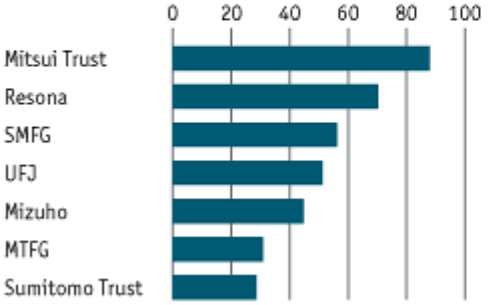
Japan's financial regulator, the Financial Services Agency (FSA), insists that no other big bank has had similar trouble with its accountants. This should be borne out when the banks publish their results on May 26th. Nonetheless, Resona's troubles sent bank shares tumbling, and with good reason. Resona is not the only bank whose deferred tax assets account for a large proportion of its capital base and which is making big losses (see chart). As long as the outlook for profits remains weak, there is a risk that

others' reliance on deferred tax assets could be called into question in future—say at the end of September, the next time the banks draw up their accounts. With the economy in recession, and with deflation showing no signs of abating, more and more borrowers are getting into trouble. Other lenders may yet have to beg for public money.

Under water

Japanese banks':

deferred tax assets as % of tier 1 capital
September 30th 2002



consolidated net losses, ¥bn, year ending:

	March 31st 2002	March 31st 2003*
Mitsui Trust	-278	-50
Resona	-932	-838
SMFG	-464	-470
UFJ	-1,230	-650
Mizuho	-976	-2,380
MTFG	-152	-185
Sumitomo Trust	-42	-73

Sources: Goldman Sachs; Toyo Keizai, company reports

*Estimate

The Resona episode has also raised questions about the FSA. What is the point, asks Yasuhisa Shiozaki, a politician in the ruling Liberal Democratic Party, of a banking regulator that has to rely on private auditors to check banks' measurement of their capital? The FSA has been promising reforms, but so far to little effect. Its boss, Heizo Takenaka, the financial-affairs minister, tried to introduce a cap on the amount of deferred tax assets banks can count as capital when he was appointed last September; but he was beaten back by politicians, bankers and even bureaucrats within his own ministry. The FSA says a committee is discussing stricter rules—but admits that it does not know when or if they will be implemented.

Reviving Resona

Having been taken by surprise, the FSA is now trying to explain how it will “revive” Resona. It says it will send a 13-strong team to monitor the bank's management. Although the bank has already announced a 30% wage reduction, among other cost-cutting measures, it is not clear how much it will be forced to change.

The FSA says it will take a “hands-off” approach. It will not even re-evaluate Resona's assets—which might reveal a yet worse capital position—before pouring in public money. Like other banks, Resona not only faces the mammoth task of getting rid of existing bad loans, which the FSA has been allowing to build up for years, but also has to tackle masses of fresh ones as the economy remains feeble.

The FSA says that Resona will first separate its bad loans from the good. This is similar to what the government tried to do in 1998 when it nationalised Long-Term Credit Bank and Nippon Credit Bank. In the event, both banks, which were later sold to private investors, were left with plenty of duds on their books. Cleaning up will be no easier this time around. Many of Resona's borrowers are small and medium-sized companies that the government has pledged to support. Politicians are likely to face a public outcry if many of these are sent, as has been suggested, to the Resolution and Collection Corporation, the state agency for collecting bad loans. Tackling Resona's bigger troubled borrowers will hurt other banks, which also hold big chunks of their debt.

Resona may have particular trouble dealing with the many quasi-governmental projects that it helps to finance in Osaka in the west of Japan, its home patch. These include big waterfront schemes, which already have huge capital deficits and continue to make big losses. Foreclosing on these will hurt local governments, which are struggling to balance their books themselves, as well as generate huge losses for other big banks.

That is why there is a risk that Resona, under pressure from politicians, might use its public money to forgive a portion of its bad debts—and keep undeserving borrowers alive. A change of management should help: but although five of Resona's directors, including its president, have resigned, their duties have been taken over by four other executives, including two existing board members. Shareholders

have little reason to put pressure on management. Beyond some dilution of their shares, they have suffered little in the latest debacle—perhaps because the government knows that some of them, such as Asahi Mutual, an insurer in deep trouble, have problems of their own. The rescue of Resona is “clearly a transfer from taxpayers to shareholders,” says Chris Walker of Credit Suisse First Boston in Tokyo.

Resona's bail-out, adds Mr Walker, appears to be a strenuous effort by the government to preserve the status quo. As such, it does little to solve the problem of over-capacity in the banking industry, which has seven big banks and hundreds of smaller ones. Instead, it hurts those banks that are trying to strengthen their operations without government help. There may be worse to come.

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Asset management

European disunion

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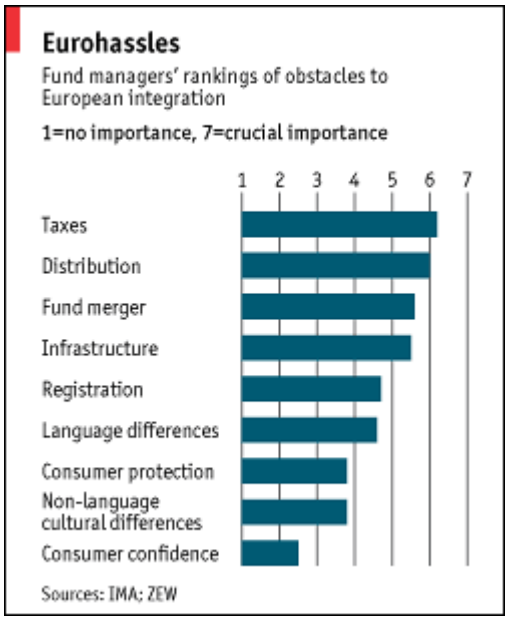
From The Economist print edition

A single European market in asset management is still a long way off

CREATING a single European market in financial services is proving painful. Only the securities markets have a fast-track method of tweaking European regulations, thanks to the recommendations of an expert panel headed by Alexandre Lamfalussy, a veteran Belgian central banker. But the barriers to cross-border dealing and investing are still legion. A report published on May 19th by the Investment Management Association (IMA), a trade body for British asset managers, shows an industry still far from being truly pan-European. Mightn't we, asks the IMA, have our own Lamfalussy process to help us along?

The IMA's study, prepared by the Centre for European Economic Research, a German institute whose initials are ZEW, estimates that a single market could bring *euro*5 billion ($5.8 billion) or more a year in added economic benefits, and increase Europeans' pension pots by about 9%. Such sums may be largely guesswork, but the obstacles to trading are clearly formidable and costly.



Asset managers in Britain see discriminatory taxes as the biggest obstacle to selling their wares in other EU countries. The worst offender is Denmark, which is practically closed to foreign entrants, says Friedrich Heinemann, one of the authors of the study. In February, only 17 foreign funds were registered in Denmark. The tax benefits for a *Plan d'Epargne en Actions*, a French investment scheme similar to Britain's individual savings account, are available only to locally managed funds. Austria discriminates against foreign investment funds with its *Sicherungssteuer*, a tax on income from such funds.

Nor can fund managers easily buy their way into new markets. Rules for mergers differ considerably between countries. Mergers in Britain are straightforward, but German regulations make it hard even for two domestic funds to join forces: they require one to shut down first. Luxembourg makes cross-border mergers practically impossible by demanding that 100% of fund holders approve them. All this may help explain why European funds tend to be sub-optimal in size. The EU has three times as many funds as America, even though Europe's overall investments are only half as big.

Although a single European “passport” for asset managers was established 18 years ago, funds still need to register with regulators in each country. That can be cumbersome, especially in Italy, say fund managers. It causes some firms to focus only on bigger countries, leaving consumers in smaller ones with less choice. “There may be a single passport but you still need a visa for each country,” says Sheila Nicoll, the IMA's deputy chief executive.

A study for the European Commission in 2001 identified 15 barriers to the efficient clearing and settling of securities across national borders, which add significant costs to European investors. The order-routing services of Clearstream, Crest and Euroclear, the main European securities depositories, provide processing systems that are incompatible. There is still no “straight-through-processing”, a jargony term for a system that allows securities trades to be cleared and settled instantaneously.

To cure these ills, the IMA has come up with a list of proposals, although it has modest expectations of their success. Among other reforms, the group wants to end regulatory and tax discrimination against foreign funds and cross-border mergers, scrap the registration of funds country by country, and

standardise procedures for clearing and settlement. But it took 15 years to negotiate the 1985 EU directive on UCITS (undertakings for collective investment in transferable securities) and another ten years to pass the first amendments to it. “In the foreseeable future we cannot catch up with America's unified financial market,” says Mr Heinemann, “but we can at least try to narrow the gap.”

Despite European fund managers' claims that they fully support efforts to bring down barriers to a single market, they have a built-in bias towards domestic funds. German managers are reluctant to sell Italian funds. Their British counterparts do little to advertise French products. Why bother when their clients prefer names they know and can pronounce?

The preference for home-grown products is supported by a heavy dose of protectionism. Italian pension funds are obliged to appoint Italian fund managers. Belgian pension funds are required to invest in Belgian government debt, and the Dutch do not get tax relief on contributions to foreign pension funds. Will that home bias diminish as, sooner or later, the barriers come down?

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Asset managers' pay

What pain?

May 22nd 2003
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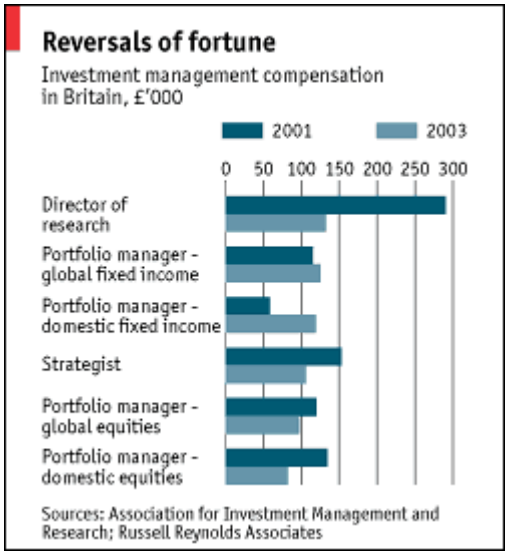
Compensation, though still handsome, reflects the market downturn



TWO years ago the asset-management industry in Britain was obsessed with equities and spurned bonds: that was evident in the way asset managers rewarded their employees. In 2001, the average income of someone managing a portfolio of domestic equities was £134,000 ($193,000), while his humble counterpart on the bond desk got less than £60,000 (see chart).

Come 2003, the situation is reversed. The now quite obviously brilliant fixed-income chappie gets a recession-beating £120,000, while the lacklustre lad in equities gets a mere £80,000. A director of research—whose importance has diminished, thanks to scandals in America—has seen his lordly pay fall by more than half, though to a still reasonable £130,000.

This is what asset managers like to call “sharing the pain”. A global survey of compensation paid by investment-management firms, released last week, shows that there has been only a small element of pain-sharing to reflect the decline in market performance since 2001—much less than that suffered by investors. Average total compensation enjoyed by asset managers in the biggest financial centres fell from $190,000 to $148,000. But it is still $170,000 in Boston and London, and $200,000 in New York. Average pay varies with the type of firm: hedge funds pay their managers on average $230,000, well above the rest of the street. Big American hedge funds, with more than $5 billion under management, pay an average of more than $300,000.

The Association for Investment Management and Research (AIMR) and Russell Reynolds Associates, a head-hunting firm, sifted replies from over 16,000 AIMR members, including banks, broker/dealers and fund managers, in North America, Britain, Hong Kong, Japan, Singapore and Switzerland. The survey does not show much individual suffering, although it omits other forms of cost-cutting, such as reducing the headcount. It shows that the gap between men's and women's pay has hardly narrowed in aggregate; but in Britain, where women were paid 24% less than men in 2001, the difference has fallen to 3%.

But are these people happy? Almost half of them feel they are underpaid, and almost half that their pay is just right; only 2% feel they may be taking more out of the pot than they put in.

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China's financial markets

Bush telegraph

May 22nd 2003 | HONG KONG
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How an American woman is filling China's financial-information gap

Bush puts down roots

BROKERS and fund managers in China are a macho lot, not at all used to doing business with petite, blonde American women. Dealing with Fredy Bush, the founder and boss of Xinhua Financial Network (XFN), a sort of fledgling Chinese Bloomberg, can therefore be an unsettling experience. “They find a way to test me,” says Ms Bush good-humouredly. This usually involves too many toasts with shots of *bai jiu*, a potent liquor.

Ms Bush is just one of many who noticed the glaring malfunctions in China's capital markets. She is also one of the few to have spotted a way of making money by tackling one of the problems: China's dismal lack of financial information.

Until Ms Bush arrived on the scene, China had no market intelligence to speak of. Its only official news agency, Xinhua, is an arm of the propaganda ministry; its journalists have no training in finance, and certainly no culture of digging aggressively for stories. The country's individual investors (69m of them, says the government; more like 10m, says Stephen Green, author of a recent book on China's stockmarket) do use news websites, but these offer little more than market gossip. Institutional investors used to have no dedicated wire service at all.

Nor did investors have proper benchmarks. China's two stockmarkets, in Shanghai and Shenzhen, calculate market averages. But neither adjusts for the small portion of shares that are actually available to investors: an important omission, because the government typically owns about two-thirds of the firms listed. Nor are there industry-specific averages. This absence of proper indices is the main reason why China still lacks a liquid market in derivatives.

The dearth of information went further. With no market for corporate bonds to speak of, there were no credit ratings. Foreign and Chinese firms that wanted to enter joint ventures had no way of gauging the counterparty risk of potential partners.

XFN, founded in 2000, has now largely plugged institutional investors' information gap. It dispatches over 300 wire stories a day, mostly to proprietary terminals on the desks of Chinese fund managers. It issues credit ratings. Unsolicited by the companies being assessed, these ratings appear to be forcing many managers to behave better. And it issues a series of indices, properly weighted by the free float of shares. In April, one of China's mutual-fund companies launched the first family of funds linked explicitly to XFN's indices—one for high-tech shares, one for cyclical stocks, and so on.

The key, as so often in Chinese business, was to link western know-how with Chinese connections. For the former, Ms Bush brought in FTSE, a British firm that calculates (among other top share benchmarks) London's FTSE 100 index. For the latter—and this was her biggest and most controversial coup—she formed a partnership with Xinhua. Ms Bush stresses that Xinhua provides no capital and no employees: if it did, XFN's editorial credibility might be undermined. Instead, it supplies influence: opening doors, keeping XFN out of bureaucratic tangles, and, not least, protecting it from other western rivals, which need Xinhua's approval to expand their reporting in China.

Xinhua itself has promised Ms Bush that it would not launch a rival service for 20 years. So long as China continues to open and reform its capital markets, XFN's services should therefore be in demand. That should fortify Ms Bush as she prepares to down another shot of *bai jiu*.

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Legg Mason

Bucking the trend

May 22nd 2003 | NEW YORK
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At least one firm knows how to survive a bear market

Master Mason

IN 1999 Raymond “Chip” Mason was an unusual chief executive of a leading securities firm: he freely admitted that he had no idea where his industry was heading. These days, he still stands out: as one of the few who knew the industry had lost its way.

As the confusion of the late 1990s dissipates in lawsuits, anger, layoffs and losses, it is plain that Legg Mason, the Baltimore firm Mr Mason heads, largely avoided the seductive pitfalls of those fevered times, to its benefit today. Its results for the year to March would look good at any time. In the present environment, they are stunning. Revenues and assets under management are at record levels. Profits are 22% higher than they were when the market peaked. Although Legg Mason, as a regional firm, has a lowish profile, the market has noticed it: its shares trade at 21 times (last year's) earnings, compared with 17 for Goldman Sachs and 14 for Citigroup.

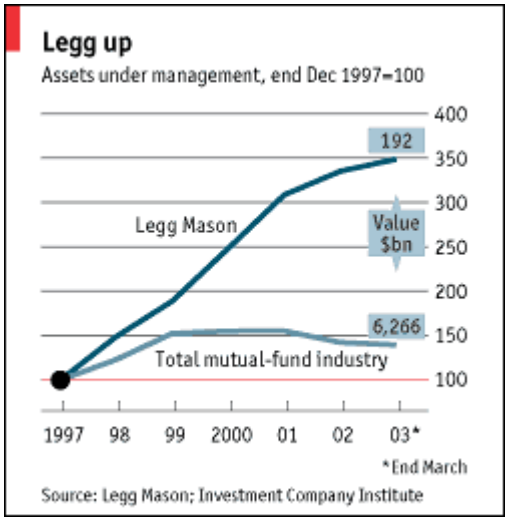
The length of Mr Mason's tenure has probably helped. In an industry where many retire (or quit) young, he has been around a long time, having founded Legg Mason's predecessor in 1962, when he was 25. The original three-person office grew quickly, before merging with another Baltimore firm in 1970. Results thereafter were consistently good, but by the late 1990s Legg Mason found itself on the wrong side of all the hot trends.

Now, that looks like the right place to have been. Legg Mason never put much into investment banking: so it missed the huge profits from initial public offerings—and then the investigations into spinning and fraudulent research that have blighted Wall Street. The firm never put much capital into proprietary trading: so it missed the rewards of the bull market—and then the losses in the crash. Convinced that its clients wanted to meet brokers, it eschewed the internet and call centres: that cost it buzz, and some savings—but maintained the morale of staff and the loyalty of customers. It also chose not to buy other full-service firms, having been badly bitten in the 1980s: that cost it growth—but spared it the indigestion that goes with mergers.

Instead, Legg Mason concentrated on buying or developing asset-management operations, which now provide 60% of profits. Its success stems from two decisions taken many years ago. In 1986 Mr Mason spent $16m on a little-known firm specialising in bonds, Western Asset Management. Western now has more than $115 billion in assets under management, and earns more than ten times its purchase price annually. Better still, as a fixed-income manager, it has done better as the economy has done worse, supporting Legg Mason's results when revenue from equity transactions has been diminishing.

Mr Mason's other smart move had come earlier, in the late 1970s. He noticed that every day a young man would drop in to pick up his wife, a Legg Mason employee—and would have to be dragged out of the firm's small library every night. Thinking someone so interested in the business might have a special aptitude for it, Mr Mason offered William Miller a job as an assistant on the firm's small mutual fund, the Value Trust. Mr Miller turned out to be astonishingly good: the Value Trust has outperformed the S&P 500 for each of the past 12 years. Assets in the Value Trust and similar institutional offerings now amount to $22 billion.

Returns have been only part of Mr Miller's contribution. His letters to shareholders have become as much a part of a financial education as Warren Buffett's, and his portfolio the source of widespread scrutiny. Amazon, Tyco, and Waste Management have all been held by Mr Miller when they were widely loathed by others. Usually, Mr Miller's strategy is to provide reason at times of panic. A side benefit has been a mountain of press coverage on Legg Mason's investment prowess that no amount of advertising could produce.



If it is any solace for the rest of Wall Street, both Mr Miller and Mr Mason have become increasingly optimistic about the prospects for the stockmarket and for their industry. Mr Miller believes that share prices bottomed last October. Mr Mason has long since shed the sense of confusion he felt in 1999. He believes that the current environment is nothing worse than a classic bear market following a boom, not unlike the late 1960s and early to mid-1970s, though not quite as wrenching. Trading will surely return to record levels in five years at most, probably much sooner. Rather than cutting jobs, the common Wall Street preoccupation, he is adding staff, including brokers.

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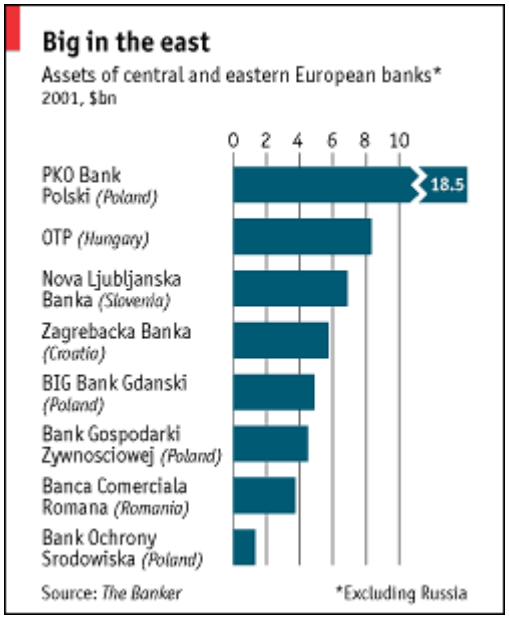
Central European savings banks

A tale of two banks

May 22nd 2003 | WARSAW
From The Economist print edition

While Hungary's OTP impresses, Poland's PKO flounders



FORMERLY a monopolist lender to the Hungarian masses, now a fast-growing, privatised universal bank, Orszagos Takarekpenztar es Kereskedelmi Bank (wisely shortened to OTP) is giving larger western rivals a run for their money. On May 20th OTP bought DSK, Bulgaria's second-largest bank and the last in state ownership, having seen off Austria's Erste Bank with a *euro*311m ($364m) offer.

This is OTP's second foreign acquisition—it bought IRB, a Slovakian bank, in 2001—and it is looking for more. Although some analysts, seeing no synergies in retail banking in different countries, think it overpaid for DSK, OTP believes it can replicate its domestic success in eastern Europe's less developed markets. It deserves the benefit of the doubt. For a post-communist financial group, OTP is a rarity: Hungary's biggest bank is not only acquisitive, but also profitable and independent.

Its return on equity has been 20%-odd since it went public in 1995. Unlike most of the region's banks, it restructured itself without a western partner (although McKinsey, a ubiquitous consulting firm, advised it on cost-cutting). Having trimmed its headcount sharply and upgraded its risk-management systems to cope with a boom in mortgage lending, OTP has built up strength at home. It may lose its cherished autonomy after Hungary joins the European Union in May 2004: if governments have to give up their “golden shares” in national champions, it may fall to a foreign bidder. For now, however, it is fit to shop abroad itself.

The same cannot be said of others—in particular, PKO Bank Polski, Poland's savings giant, although it has the advantage of having central Europe's biggest economy as its base. The last of the region's big banks still in state hands, it was excluded from privatisation in the early 1990s because of its crippling legacy of communist-era housing loans. Although successive governments have groomed PKO for sale by guaranteeing most of its old housing credits and shoring up its skimpy capital, the bank has avoided aggressive restructuring. Unlike OTP, it is woefully overstaffed and has yet to overhaul its IT systems. “They couldn't be more different,” says Paul Tucker of Merrill Lynch.

Still, PKO's sheer size makes up for some of its competitive shortcomings. It boasts nearly one-quarter of Polish retail deposits, despite fierce competition from nimbler foreign-owned rivals. It has also spruced up its dull image and introduced catchy products. But it will probably not restructure properly unless it is privatised. The government, though, is determined to keep majority control. It plans to sell 30% on the stockmarket, but has yet to appoint an adviser. Meanwhile, OTP shows what might have been achieved.

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Political-risk analysis

The new bull market

May 22nd 2003 | NEW YORK
From The Economist print edition

Investors want opinions on global fragility more than corporate insights

LAST year investors craved analysis of arcane corporate accounts. The year before they clamoured for intelligence on upwardly mobile technology stocks. But this year there is no hotter commodity than political risk: will governments fall, will countries go to war (of the conventional or trade variety), what chance of a nuclear exchange? And if so, who will benefit?

A visible beneficiary of this phenomenon has been Eurasia Group, a small consultancy founded on the idea that politics often matter at least as much as economics for businesses and investors. Five years ago Eurasia consisted of one man, Ian Bremmer, a few computers, and a letterhead. Now it has 40 full-time employees and another 480 part-timers spread over 65 countries—an inspiration for any academic with a seemingly useless degree in political science. According to Mr Bremmer, revenues were $8m in 2001 and $15m last year, with $30m possible this year. In future even $100m is thinkable if his client base, currently numbering 130, expands beyond America. Most consultancies these days are happy if they are just shrinking slowly.

Eurasia's customers include big banks and investment-management firms, along with the usual multinationals. They are bombarded with an ever-expanding list of products, ranging from niche studies ("New Kazakh Politics: Inside the Ministry of Energy"), to meetings with various foreign potentates, seminars on trade, weekly e-mails and snap transmissions on disasters. Multinationals favour in-depth studies; hedge funds, unsurprisingly, like direct calls on things that could unsettle markets.

Newspapers and broadcasters call on Eurasia too. In a joint venture with Lehman Brothers it produces a monthly index of political risk, reprinted in *The Economist*. Mr Bremmer writes a monthly column for the *Financial Times* and frequently appears on news shows.

There is no market price to punish Eurasia if it happens to be wrong. In fact, it is almost impossible for an outsider to second-guess its utterances. It will be years, for instance, before the accuracy of the stability index can be judged. Wrong calls are quickly forgiven and forgotten. A month ago Eurasia suggested "coalition forces may face a determined defence of Baghdad" but that was hardly a wild guess. Other predictions it has made have been spot-on.

Certainly, when news is so effervescent, there is appetite for the seemingly informed take: on Turkey (a "loser" in the Iraq war); Russia (winner); North Korea (short-term better, long-term worse). The greatest political risk to Eurasia itself is peace in our time (a long shot).

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Economics focus

The devil's excrement

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From The Economist print edition

Is oil wealth a blessing or a curse?

THREE decades ago, the Organisation of Petroleum Exporting Countries (OPEC) sent oil prices rocketing. By 1980, a barrel cost $30, ten times the price in 1970. Consumers suffered, whereas oil producers reaped an enormous windfall. Many assumed then that oil was a gift of God that would transform poor countries into flourishing economies within a generation. Yet even during those heady early days there were doubts. Juan Pablo Pérez Alfonso, a founder of OPEC, complained in 1975: “I call petroleum the devil's excrement. It brings trouble...Look at this *locura*—waste, corruption, consumption, our public services falling apart. And debt, debt we shall have for years.”

Several new publications argue that history has proved him right. A new book from the Open Society Institute, a foundation financed by George Soros, points out that resource-poor countries grew two to three times faster than resource-rich countries between 1960 and 1990 (even after adjusting for differences in population, initial income per head and other variables). Revealingly, the resource-rich countries began to lag only after the 1970s—in other words, only after oil wealth started to pour in.

Two factors explain this. The main economic problem is known as Dutch Disease, after the effects of the discovery of natural gas in the Netherlands in the 1960s. An oil bonanza causes a sudden rush of foreign earnings; this drives up the value of the currency. That, in turn, makes domestically produced goods less competitive at home and abroad. Over time, domestic manufacturing and agriculture fade and growth suffers.

Tricky as this problem is, oil economies such as Norway and Alaska have come up with a clever (though still imperfect) solution: they hive off much of the oil income into “stabilisation” funds, disbursing “dividends” to citizens slowly—directly in Alaska, via social spending in Norway—so that the economy does not overheat. Chile, one of the world's more successful developing countries, has a similar fund for its copper revenues.

Contrast this cautious approach with the recklessness of the OPEC countries of the Middle East, which expanded domestic spending by about 50% a year between 1974 and 1979. This enriched the elite, but spawned white-elephant projects and fuelled inflation of more than 15% a year. Venezuela has earned over $600 billion in oil money since the 1970s, but the real income per head of its citizens fell by 15% between 1973 and 1985. It is falling again today.

On top of these economic difficulties can come even worse political problems. Because oil infrastructure can be controlled easily by a few, it often leads to a concentration of political power. Michael Ross, of the University of California at Los Angeles, argues that oil worsens poverty by stunting democratic development, among other things. It also tends to cause, or at least aggravate, civil wars. A new report by Christian Aid, a charity, says that oil economies are more likely than non-oil economies to maintain large armies, and generally do worse on literacy, life expectancy and other measures of human development. In addition, sudden oil wealth affords ample opportunity for corrupting the politicians who award contracts to foreign oil firms.

Wishful thinking?

These recent reports are troubling, but is there really any prospect of change? Surprisingly, the answer may be yes. For some time now, Publish What You Pay—a collection of activist groups—has been pestering Big Oil to reveal all the payments it makes to governments, which usually insist that such

details be kept secret. Now some big investors are getting in on the act too. On May 19th, ten investment funds managing some $600 billion of assets declared their support for transparency: “This is a significant business risk, making companies vulnerable to accusations of complicity in corrupt behaviour...and possibly compromising their long-term commercial prospects.” Tony Blair has been promoting the Extractive Industries Transparency Initiative, a scheme that calls for voluntary disclosures. Britain now plans to push for an international approach by raising the topic at the G8 summit in France next weekend and at a ministerial meeting on June 17th.

A multilateral approach would certainly be more realistic than any national or unilateral steps. That is what BP discovered when it recently voluntarily revealed the terms of its contracts in Angola. No other oil company followed suit, and the local powers let it be known that they were displeased. A multilateral approach could involve the World Bank and the International Monetary Fund, which could push countries to publish the details of contracts and to set up resource funds. Some countries howl that such initiatives violate their sovereignty, but that is a smokescreen: rulers with nothing to hide would surely welcome transparency. Others, including Abu Dhabi and Kazakhstan, boast that they already have such funds—but these are weakened by a lack of proper oversight. In contrast, the American proposal for dealing with Iraqi oil revenues could result in the creation of a fund monitored by Kofi Annan.

But reform will not be easy. The World Bank recently demanded transparency in return for backing a controversial pipeline running from Chad to Cameroon. After much hesitation, both countries agreed to set up mechanisms that will allow outside monitoring of oil revenues and vowed that the funds will be used only for development purposes. The ink had barely dried on the accord when Chad's ruler was caught diverting oil money to military spending. Getting firms to “publish what you pay is an essential first step,” observed George Soros at the launch of the Open Society book, but the harder step is to get governments to “publish what you receive...and then be accountable for what you receive.”

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Ethernet

The big three-O

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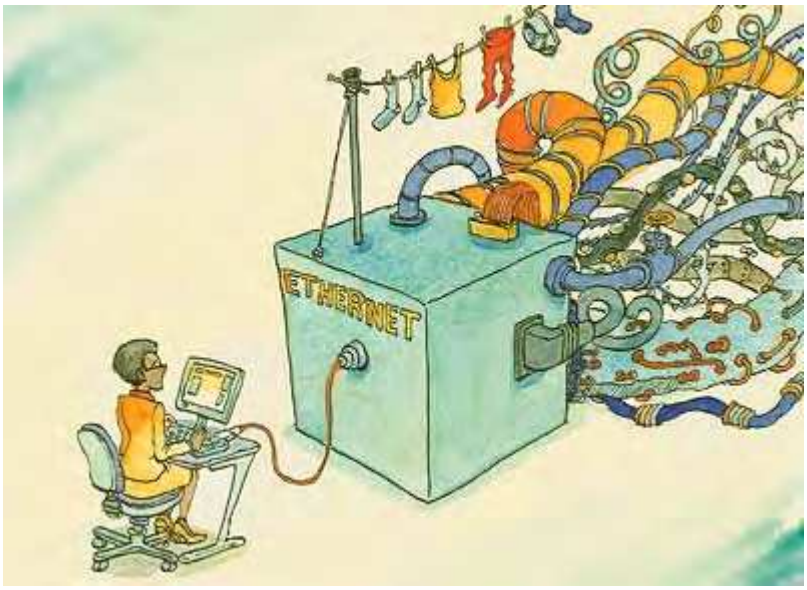

The longevity of Ethernet has lessons for today's information technologists

WHEN Ethernet, now by far the most popular way of distributing data around local networks, was devised by Bob Metcalfe in a memo on May 22nd 1973, at Xerox's celebrated Palo Alto Research Centre (PARC), it was designed to send data at about 3 megabits per second. Today, 1 gigabit per second Ethernet is common and speeds of 100 gigabits per second are being developed. The vast majority of the internet's traffic begins and ends its journey on Ethernet networks, which are found in nearly every office network and home broadband connection.

It was not supposed to be this way. Few imagined that this particular networking protocol would last as long as it has. Indeed, the landscape is littered with better-financed, better-backed rival protocols that failed against Ethernet. IBM's Token Ring system is one famous casualty. Asynchronous Transfer Mode, supported by the telephone industry, is another. So the case of Ethernet is worth examining: the reasons for its longevity may offer lessons to the information-technology industry.

Keep it simple, stupid

The first reason is simplicity. Ethernet never presupposed what sort of medium the data would travel over, be it coaxial cable or radio waves (hence the term “ether” to describe some undefined path). That made it flexible, able to incorporate improvements without challenging its fundamental design.

Second, it rapidly became an open standard at a time when most data-networking protocols were proprietary. That openness has made for a better business model. It enabled a horde of engineers from around the world to improve the technology as they competed to build inter-operable products. That competition lowered the price. What is more, the open standard meant that engineers in different organisations had to agree with each other on revised specifications, in order to avoid being cut out of the game. This ensured that the technology never became too complex or over-designed. As Charles Spurgeon, author of “Ethernet: The Definitive Guide” puts it, “It always stayed close to the ground. It addressed problems customers came up against, not problems that networking specialists thought needed to be addressed.” That, coupled with the economies of scale that come from being the

entrenched technology, meant that Ethernet was faster, less expensive and less complicated to deploy than rival systems.

Third, Ethernet is based on decentralisation. It lets smart “end-devices”, such as PCs, do the work of plucking the data out of the ether, rather than relying on a central unit to control the way those data are routed. In this way, Ethernet evolved in tandem with improvements in computing power—a factor that was largely overlooked by both critics and proponents when Ethernet was being pooh-poohed in the 1980s and early 1990s.

Beyond the technology, there is even a lesson for companies investing in research, albeit one learned through tears rather than triumph. Xerox failed to commercialise Ethernet, as it similarly missed exploiting other inventions created at PARC, such as the mouse and the graphical user interface. To develop Ethernet fully, Dr Metcalfe had to leave PARC and found 3Com, now a big telecommunications-component firm. The lesson may have sunk in. In January 2002 PARC was carved out as an independent subsidiary of Xerox. That allows it to explore partnerships, spin-offs and licensing agreements without having to get its parent's permission.

And the future? Many geeks believe the fashionable wireless standard 802.11b, better known as Wi-Fi, is poised to become the next iteration of the technology, once concerns about its security have been resolved. Wi-Fi is able to deliver cheap internet access at a rate of many megabits-per-second, and it can do so at a range of up to 100 metres. Dr Metcalfe, who based Ethernet's early designs on a radio network called AlohaNet, that linked the Hawaiian islands, sees Wi-Fi as “Ethernet coming home”.

That raises the question of whether a technology that outlived even its inventor's expectations will ever be supplanted, or whether it will continue to be upgraded indefinitely. As Dr Metcalfe quips, “When something rises up to defeat Ethernet, it's very likely that they're going to call it Ethernet.” Now that, indeed, is adaptability.

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Relativity

There was a young fellow called Bright...

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Light can travel faster than light. Sort of

NOBODY likes being late for an appointment. So it would be a boon indeed if you could arrive somewhere before setting out. That is what Daniel Gauthier and his colleagues at Duke University in North Carolina have managed to do, after a fashion, with pulses of light.

Light normally travels fastest in a vacuum. But on May 22nd Dr Gauthier revealed to a meeting of the optics division of the American Physical Society, in Boulder, Colorado, that this is not always the case. Parts of a light wave can be accelerated beyond this speed by passing the wave through a vial of energetic potassium atoms. On the face of it, this contradicts Einstein's special theory of relativity. So, rather than saying as Einstein did that nothing can be faster than the speed of light in a vacuum (abbreviated as *c*), physicists now prefer a more precise version: information cannot travel faster than *c*.

Dr Gauthier began his experiment with a vial of gaseous potassium and a laser. He used the laser to excite the potassium atoms in a particular way, illuminating the vial with two slightly different frequencies of light. He chose the difference in frequency between the two beams so that it would match the difference in energy required to excite electrons in the potassium atoms by a specific amount, known as a Raman transition. If another pulse of laser light, with a frequency between that of the two steady beams, was then sent into the gas, it sped up.

Dr Gauthier is not the first to perform this trick, but his predecessors, who used rubidium rather than potassium, got only a weak effect. Their results were obscured by so-called “non-linear” processes that interfered with the speeding-up. Dr Gauthier's results, by contrast, were so clear-cut that portions of the laser pulse appeared to leave the vial before they entered it.

There is, however, no cause for alarm. What Dr Gauthier was manipulating is actually something called the “group velocity” of the pulse. Loosely speaking, this is the speed at which the pulse's crest travels. When he looked closely at the leading edge of the pulse, he found that it travelled at the plain old speed of light, *c*.

That is where the rewriting of Einstein to refer to information comes in. Because the pulse is smooth, the appearance of the “superluminal” crest can be inferred mathematically from the shape of the pulse's leading edge. That means no additional information is conveyed by the arrival of the crest itself. In other words, any information encoded in the crest is not travelling faster than light—and the (modified) version of relativity still holds water.

Dr Gauthier found himself wondering, however, what would happen if he introduced a jump into the pulse. Because the jump would be sudden, it could not be predicted by observing the leading edge of the pulse. In other words, it might be used to convey information at superluminal velocities. But nature seems to have thought of that one. The group's latest experiment, which Dr Gauthier told the conference about, showed that the jump is not accelerated in the same way that a smooth crest is, but travels only at *c*. The details of why the jump causes the pulse to slow down are not well understood. But it seems that physicists are not going to outsmart Einstein's century-old theory just yet.

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Human evolution

Girl power

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When the going gets tough, have daughters

AFP

Thinking of the grandchildren

IN MOST species, people included, males and females exist in more or less equal numbers. There is a good reason for this. Suppose females were rare. Lots of males would fail to reproduce. So a genetic mutation that caused parents to have more daughters than sons would be rewarded with extra grandchildren. Thus it would spread until it ceased to bring further advantage, in other words when the sexes were equal in number. *Mutatis mutandis*, the same argument applies if it is males who are rare. But what applies in general, does not always apply in particular. There are circumstances when it might behove an individual mother to give birth preferentially to sons or to daughters. In a paper just published in the *Proceedings of the Royal Society*, Mhairi Gibson and Ruth Mace, of University College, London, outline such a case in people.

The mothers concerned are Ethiopian. Some are malnourished. Those that are, seem more likely to give birth to daughters than sons. Dr Gibson and Dr Mace used two measures to assess how well-fed the mothers were. The body-mass index measures fat and muscle, but cannot distinguish between them. The mid-upper-arm muscle-area index is able to make the distinction. In both cases, there was a clear correlation between how malnourished a woman was and how likely her most recent child was to have been a girl. In the case of the muscle-area index, the best-fed women were more than twice as likely to have had a son recently than the worst-fed.

There are two possible explanations for this. One is that the cost to the mother of bearing sons is greater than that of bearing daughters. That is suggested by the fact that women who have borne only sons have shorter lives than those who have borne only daughters. A mother who is well nourished probably tolerates such costs better than one who is not. Better, then, for a starving woman to abort a male fetus early and hope for better times, or for a daughter next time round.

The other explanation is not the prospects of the mother, but those of the child. In most species, people included, the reproductive output of males is more variable than that of females. Successful males have lots of offspring, unsuccessful ones few, or even none. A female's output is likely to be closer to the average. Since both health and height contribute to male success, and both are reduced by gestating in the womb of a malnourished woman, there may be little point, in terms of grandchildren accrued, to such a woman giving birth to a son.

These explanations are not, of course, mutually exclusive. Indeed, if both were true they could add up to a very powerful effect. Exactly what, in fact, Dr Gibson and Dr Mace observed.

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Mouse evolution

Town mouse, country mouse

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Dusty museum specimens still have scientific value

IT IS rare to be able to point to a clear genetic change that might be the result of natural selection in a changing environment, but Oliver Pergams, of the University of Illinois at Chicago, and his colleagues seem to have done so. As they report in *Nature*, they have studied changes in the DNA of the white-footed mouse during the past 150 years. That they were able to do so is due to the efforts of museum curators over this period.

By diligent searching, they were able to track down museum collections (one as far afield as Switzerland) that had been made from five sites in the Chicago area. They obtained 61 mouse skins this way, and trapped a further 52 mice to see what the modern version looks like.

The DNA they chose to study was from mitochondria. These are the cellular structures responsible for releasing energy from glucose, and they have their own chromosomes. Students of ancient DNA like them because each cell has lots of identical mitochondrial chromosomes, but only one or two copies (depending on how close it is to dividing) of the main nuclear chromosomes. That makes extracting mitochondrial DNA easier.

Dr Pergams chose a stretch of DNA 340 base pairs long (a base pair is one of the chemical “letters” in which the genetic code is written). He found two common variants, known as haplotypes A and M, of this stretch. The variants differed by four base pairs. All five collection sites showed a consistent pattern: haplotype A was gradually replaced by haplotype M. In the Chicago area, the former is now almost extinct. The change coincides precisely with the settlement of Chicago, suggesting that, for mice, living in an urbanised habitat is easier if you are haplotype M.

Of course, correlation is not causation. But it is suggestive. There is, however, another problem. The four variations between A and M are what is known as silent mutations. In other words they make (because of redundancies in the genetic code) no actual difference to the composition of the protein encoded in this part of the chromosome. It is, therefore, hard to argue that natural selection could favour M over A on the basis of these differences. What is likely is that the A and M haplotypes vary elsewhere, too, and that some of those variations make a difference to protein composition, and thus to a mouse's success.

It is a pity that the team studied silent mutations, but it is hardly a cause for criticism. Working with DNA from long-dead individuals is not, despite the image portrayed by “Jurassic Park”, an easy thing to do. DNA is a fragile molecule, and it tends to break up into short sections fairly quickly. The pieces Dr Pergams was dealing with were a mere 400 base pairs long, on average. Hence the choice of a section 340 pairs long for study. The whole mitochondrial chromosome, by contrast, is 16,000 base pairs long. Dr Pergams was unlucky to be working with silent mutations. Better luck next time.

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Third-world medicine

Testing times

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From The Economist print edition

A new organisation should help the diagnosis of diseases in poor countries

WILLIAM OSLER, one of the founders of modern medicine, observed that the best means of diagnosis was one finger in the throat and one in the rectum. Things have moved on since then, at least in rich countries. But in the world's poorest places modern diagnostic technology is in short supply.

Take tuberculosis (TB), for example. The standard method of diagnosis is a microscopic hunt in a sample of sputum for the bacteria that cause the disease. Even when a country can afford the equipment and people to do this, it is a time-consuming and inaccurate procedure. As a result, many patients are well into the disease by the time they are diagnosed, a delay that not only undermines their chance of recovery, but also exposes their neighbours to infection.

There is thus a need for fast, accurate and affordable diagnostics for the diseases which hit the poor hardest. What has been lacking, so far, is much international co-ordination and funding to develop and distribute these where they are required. No longer: May 22nd saw the launch of the Foundation for Innovative New Diagnostics (FIND), which draws on the World Health Organisation's expertise in infectious disease, and on $30m from the Bill & Melinda Gates Foundation. Over the next five years, the foundation will focus on bringing better tests for TB into the field, before moving on to other poor-country afflictions, such as malaria.

As Mark Perkins, the scientific director of FIND, points out, there are plenty of ideas for new diagnostic tests in academic centres and biotechnology companies around the world. For TB alone, more than 50 firms are developing or already selling tests that might be useful in poor places. These include dipsticks that can detect antibodies to TB bacteria, patch tests that reveal infection by the way the skin reacts to bits of those bacteria, and DNA chips which can identify the germ from its genes.

The problem is that most of these firms (and also the academic groups) are too small to do the research needed to adapt their ideas for use in poor countries, let alone make them in bulk for Africa, Asia and Latin America and push them over regulatory hurdles in those places. FIND's role is to bring governments, firms and universities together, and give them enough money to do the job. Providing developing countries with better access to expensive, life-saving drugs has become an international rallying cry. Combined with better diagnostics, these medicines could, indeed, make a world of difference.

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Mount Everest

Writers with altitude

May 22nd 2003
From The Economist print edition

Reuters

Human beings are enthralled by mountains—and mountain literature. We examine the history of a literary genre, and choose the season's best new offering

ON MAY 29th 1953, at a little before noon, the earth's highest peak, Mount Everest, was scaled for the first time. Western infatuation with mountains has deepened over the past half-century. More than 10m Americans go climbing every year; 50m go hiking. In Britain, 4m people consider themselves to be hill-walkers of one stripe or another. Sales of outdoor products are estimated at over $10 billion annually—and armchair mountaineering has never been more popular.

Bookshops build their own little Everests devoted to the display of titles about mountains and mountaineering. These works offer a variable mix of natural beauty, personal philosophy and vicarious fear. In addition, they seem to provide an answer to a universal, if sometimes vague, spiritual need. Maurice Herzog's “Annapurna” (1952), the most popular mountain book of all time, has sold 15m copies in 50 languages.

The attraction of altitude is not new, of course. Religions have long depicted mountains as vantage-points from which enlightenment or salvation might be gained: think of Moses on Pisgah or Dante trying to reach paradise by climbing Mount Purgatorio. Early pilgrims to mountains were astounded by the fresh vision of the world gained at great height, and they often compared themselves to gods or to what the Greeks called the *kataskapos*, the “looker-down”.

“The Snow Leopard”, by Peter Matthiessen, a distinguished American nature writer, was the first modern book to capture the spiritually elevating aspect of mountains. Published in 1978, it became an instant classic, and has remained in print ever since. Mr Matthiessen, a field naturalist, set out into the Himalayas to track a snow leopard—“the rarest and most beautiful of the great cats”—to its home on Crystal Mountain. Once embarked upon, his journey became as much an existential quest as a natural-history trek. It was, he wrote, “a true pilgrimage, a journey of the heart”, set against the backdrop of Nepal's mighty peaks. For the author—and, in no small measure, also for its readers—“The Snow Leopard” was the first book that really crystallised the sense, since hardened into a cliché, that one might find oneself in the mountains.

Books about mountains tend to divide into three types: the spiritual, the epic and the tragic. Mr Matthiessen's book epitomises the first of these. The most famous epic of recent years is Joe Simpson's “Touching the Void” (1988). In 1985, during the ascent of a remote peak in the Peruvian Andes, Mr Simpson fell into a crevasse. The impact of landing drove his lower leg up through the right knee joint.

Against all the odds, Mr Simpson escaped from his mountain tomb and dragged himself to safety over six miles of glacial moraine. “Touching the Void”, his account of his escape, has sold hundreds of thousands of copies. Like “The Snow Leopard”, it is a book that slides easily back and forth between description and philosophy. Mr Simpson's meditations on risk, endurance, and death transformed his story from the mountaineering gothic-horror it could so easily have been into a moving fable about human resilience. The film rights have been sold, and Tom Cruise is said to be considering playing Mr Simpson. Exactly how Hollywood will film a man crawling for six miles along a glacier remains to be seen, but then triumph over adversity has long been a celluloid staple.

The third type of mountain book, the tragic, reached its peak with Jon Krakauer's “Into Thin Air”. In 1996 a freak storm hit Mount Everest during the key climbing season: the so-called May “weather window”. Eight climbers died in the storm. One of the survivors, an American named Beck Weathers, was frozen face down overnight at an altitude of over 8,000 metres. He lost his nose, one hand and all of his remaining fingers to frostbite.

Of the many books which were spun out of that killer storm, “Into Thin Air” was the most impressive. As an experienced feature writer, Mr Krakauer was able to convey the human dynamic of the story: the tensions, the challenges and the different personalities involved in the disaster. As an accomplished climber, he also wrote inspiringly about the beauty of the region, and he managed to explain something of the sublime madness of mountaineering.

He discussed what Mr Simpson calls “the beckoning silence”: the inverted gravity which pulls people upwards, to slopes, summits and danger. The combination of high-altitude drama, take-home vertigo and climbing philosophy proved irresistible to readers. Mr Krakauer's book sold 320,000 copies in its first month of publication, and climbed swiftly to the top of the bestseller lists on both sides of the Atlantic. There are over 3.6m copies in print.

Mountains provide an antidote to modern life and its dreary preoccupation with maximising comfort and minimising risk. They offer particular qualities—remoteness, wildness, separation from the humdrum—which are denied by the increasingly cosseted and climate-controlled nature of western urban living. A growing number of people long for environments that do not respond to the flick of a switch or the twist of a dial. More than this, mountains seem increasingly to provide a much-needed spiritual resource. Even when flattened into book-form, they offer a viewpoint from which people can not only look across extraordinary and mysterious landscapes, but also down into themselves.

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Mountain books

Try this one

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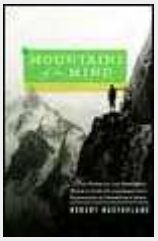
OF ALL the books published to mark the 50th anniversary of climbing Mount Everest, Robert Macfarlane's “Mountains of the Mind” stands out as by far one of the most intelligent and interesting.

As a climber, he well understands how “the mountains one gazes at, reads about, dreams of and desires are not the mountains one climbs.” As a scholar, he teases out how perceptions of mountains have changed over the past three centuries, and he seasons his text with personal memories of peaks scaled and chilblains earned.

Mr Macfarlane argues that we owe these changes in cultural attitude to the protagonists of the Sublime—Burke, Addison and Rousseau—to the leading Romantic poets and to such artists as Turner, Friedrich and Ruskin. In the 19th century, mountain exploration came to be regarded as something greater than simply the preserve of a Victorian bourgeoisie who could catch the new trains to the Alps, or gritty public-school boys being groomed for empire. Mr Macfarlane delves skilfully into the cultural implications of palaeontology, geology, Darwinian evolutionary theory and the discovery of the earth's tectonic plates in a style that shows he can be as poetic as he is plucky.

Mountains of the Mind: How Desolate and Forbidding Heights Were Transformed into Experiences of Indomitable Spirit.
By Robert Macfarlane.
Pantheon Books; 320 pages; $24.
Granta; £20

Mountains of the Mind: How Desolate and Forbidding Heights Were Transformed into Experiences of Indomitable Spirit
By Robert Macfarlane



Pantheon Books; 320 pages; $24.
Granta; £20

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About sponsorship

Islamic terrorism

Who killed Daniel Pearl?

May 22nd 2003
From The Economist print edition

A French bestseller puts forward an intriguing theory

DANIEL PEARL was a *Wall Street Journal* reporter who was kidnapped in the Pakistani city of Karachi in January last year. Pearl's captors filmed themselves cutting his throat and then severing his head from his body. “I am American,” he said on camera. “I am Jewish. My family on my father's side is Zionist.”

In the distorted vision of Islamic terrorism, Pearl was a spy for the CIA or for Israel's Mossad, a man to be held hostage in exchange for the release of a senior Taliban official and Pakistani militants captured in America's war in Afghanistan. After a three-month trial that ended last July, a Pakistani court found four Muslim extremists guilty of the kidnapping and murder. Their ring-leader, the British-born Omar Sheikh, was sentenced to be hung; the other three to 25 years' imprisonment.

Qui a Tué Daniel Pearl?
By Bernard-Henri Lévy

Grasset; 536 pages; euro20

Buy it at Amazon.fr

European interest in this gruesome episode might have been expected to dwindle had it not been for Bernard-Henri Lévy, a French writer and philosopher and President Chirac's former special envoy to Afghanistan. As France's most recognisable tele-intellectual, Mr Lévy has a wide following. The very week it was published, “Qui a Tué Daniel Pearl?” jumped to the top of the French bestseller list; it has remained there ever since.

Mr Lévy, composing what he freely admits is a mix of a novelist's imagination and an investigator's evidence, offers an intriguing explanation for why Pearl might really have been killed. The journalist had been trying to make contact with Mubarak Ali Shah Gilani, the “guru” of Richard Reid, the hapless Muslim convert who tried to use explosives in his shoe to blow up an aircraft on its way from Paris to Miami. Mr Lévy believes that Pearl was close to uncovering collusion between extremist Islamic groups and officials of Pakistan's Inter-Services Intelligence agency, known commonly as ISI. Omar Sheikh was not a zealot acting outside the law but an ISI agent, Mr Lévy believes; the agency was helping supply Osama bin Laden's al-Qaeda with weapons of mass destruction and providing Pakistani nuclear secrets to both Iran and North Korea.

AFP

A taste for risk

If true, this has terrifying implications. Pakistan, supposedly President Bush's brave ally in fighting terrorism, Mr Lévy says, is playing “a double, even triple game” and could even have helped plot the September 11th attacks. What a mistake to be obsessed with Iraq, he argues, when the real rogue is a fanatical and nuclear-armed Pakistan.

Mr Lévy can prove very little of this, but it would be foolish to dismiss his theories as mere fantasy. It is beyond doubt that the ISI under its former head, Hamid Gul, aided the Taliban and had dubious links with extremist Islam. And it is beyond doubt too that Mr Lévy has been thorough. He has probed the background of Omar Sheikh, the “perfect Englishman” who abruptly dropped out of the London School of Economics. Mr Lévy's travels, sometimes on a French diplomatic passport, took him to Dubai, Afghanistan, Britain, Bosnia and even—to meet Pearl's parents—to Los Angeles. In Pakistan, here traced Pearl's steps, stayed in the same hotels and sought out the same contacts, which took some courage since Mr Lévy, despite being a declared atheist, was, like Pearl, born Jewish.

His writing has a keen sense of detail and atmosphere, which makes his book a gripping read. But it is also a sobering challenge to the Islam of tolerance and moderation: Muslims must defeat the “madmen of God, or rather the Devil” who “call for *jihad* and, explosives strapped to their bellies, aspire to die as martyrs.” As Mr Lévy points out, that battle will be *la grande affaire* of the 21st century.

Qui a Tué Daniel Pearl?
By Bernard-Henri Lévy.
Grasset; 536 pages; euro20

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Hollywood moguls

Mr Really Big

May 22nd 2003
From The Economist print edition

THE recent history of MCA/Universal Studios is littered with the failure of foreigners—Japanese (Matsushita), Canadian (Seagram), French (Vivendi)—to understand power in Hollywood. Power resides not with the studios which have seduced so many foreign buyers, but with the stars: the actors and directors, and the agents who secure their multi-million-dollar pay packets. If the upper hand in Hollywood has shifted away from the studios over the past half-century, nobody was more influential in bringing about this change than Lew Wasserman, the man who built MCA into an entertainment giant—and then sold it to the Japanese.

Wasserman, who died last year at the age of 89, was in some ways the anti-mogul. Dour, publicity-shy, reserved with women, he was the archetypal suit in a creative industry. His long-time secretary recalls in this book, which is packed with such anecdotes, that in the 1960s he expected an hourly update on the numbers taking the fledgling Universal Studios tour. If she were just a few minutes late, Wasserman would call and bellow at her. Then he would painstakingly collate the daily totals, record the weather conditions and compare the week's performance against that of the previous year.

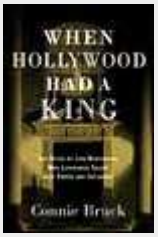
The attention to detail, the obsession with the bottom line, was typical. Wasserman applied the same unbending logic to each of his ruthlessly pursued business ventures. When he took over in 1946 at the Music Corporation of America, a talent agency which its founder, Jules Stein, had built from his days booking live bands in Chicago, Wasserman used its growing grip on talent to break the studios' power, drive up the rates for actors and force the studios to share profits with the stars. If Tom Cruise or Harrison Ford now demand upfront payments of $20m-25m a film, this is in no small part due to the mogul's efforts.

What Wasserman grasped so clearly was the value of leverage. If you could assemble a critical mass of talent, you could break the studio system. If you controlled the top movie stars, you could wrap other elements—a producer, director, lesser actors—into a deal with a star, in a practice that became known as packaging. By 1960, MCA controlled some 70% of all Hollywood stars, including Marlon Brando, Jimmy Stewart, Marilyn Monroe and Clark Gable. By the time the government forced him to divest the talent business by threatening anti-trust proceedings, Wasserman had grown into a true Hollywood powerbroker; he went on to become a polished supplier of mass entertainment, from such TV series as “The Six Million Dollar Man” and “Kojak” to such blockbuster films as “Jaws” and “E.T.”.

Wasserman once commented: “I don't consider I have power. I have relationships.” And how. At one time Ronald Reagan's Hollywood agent, he was friends with politicians from Lyndon Johnson to Bill Clinton. For 50 years, he counted as a friend and business associate Sidney Korshak, a lawyer who was investigated (though not indicted) for his links to the mob. Indeed, as Connie Bruck points out, “the culture of MCA bore no small resemblance to the Mafia's”: loyalty ruled and was rewarded, betrayal went unforgiven.

This portrait is inspired less by affection than by awe. Yet, in the interviews that Ms Bruck conducted before Wasserman's death, she was able occasionally to disarm him. The Hollywood mogul makes a rare confession of weakness: his greatest mistake, he said, was to have sold the company to the Japanese in 1990—a decision that ushered in a time of instability for Universal which continues to this day.

When Hollywood Had a King: The Reign of Lew Wasserman, who Leveraged Talent into Power and Influence
By Connie Bruck



Random House; 528 pages; $29.95

Buy it at
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Influence.
By Connie Bruck.
Random House; 528 pages; $29.95

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Butterflies

Model colours

May 22nd 2003
From The Economist print edition

BUTTERFLIES are the supermodels of the insect world. No other bug represents such mesmerising beauty, nor is imbued with such universal spiritual symbolism. The butterfly as a metaphor of transformation and rebirth has long appealed to mystics of all stripes. In ancient Greek the word psyche meant both soul and butterfly. Pope Gelasius I compared the life of Christ to that of the caterpillar: *Vermis quia resurrexit*. The worm has risen again.

Sharman Apt Russell has done a wonderful job of gathering bits of exotic butterfly lore to brighten up her account of the insect's life-cycle, its acrobatic sexual practices and its amazing gift for mimicry. There are intriguing digressions, too, into the lives of great butterfly hunters of the past, and an engaging account of some recent developments in butterfly conservation.

All of which makes for fascinating reading. “An Obsession with Butterflies” is marred only by the author's own obsession with one-sentence paragraphs, often in the form of a rhetorical question (“What happens to butterflies that don't migrate?”). But the book is full of lovely, vivid perceptions as well. Ms Russell remembers her delight, for instance, when a small grey butterfly, “common as a mailbox”, revealed to her its exquisitely coloured underside: “Scallops of mango orange. Patterns of blue and russet. A crescent, a dash, a language in code.”

An Obsession with Butterflies: Our Long Love Affair with a Singular Insect.
By Sharman Apt Russell.
Perseus Books; 238 pages; $24 and £18.99

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New fiction

Great expectations

May 22nd 2003
From The Economist print edition

MARK HADDON'S new novel comes with glowing endorsements from Ian McEwan (“superb”) and Oliver Sacks (“brilliant”). It has been sold to publishers all over the world, and the film rights have been snapped up by Warner Bros. In Britain it is available, like the Harry Potter books, in two separate editions—one for youngsters (Mr Haddon has previously published 15 children's books) and one for grown-ups.

The Curious Incident of the Dog in the Night-Time
By Mark Haddon

Doubleday; 236 pages; $22.95. Jonathan Cape; £10.99

Buy it at Amazon.com

What is all the fuss about? Certainly “The Curious Incident of the Dog in the Night-Time” is a detective story with a difference. For one thing, the murder victim is a poodle. For another, the hero and narrator is a 15-year-old boy with Asperger's syndrome, a form of autism.

Christopher is a whizz at maths and science. He has a fantastic memory and near-photographic powers of observation (“Mr Jeavons smells of soap and wears brown shoes that have approximately 60 tiny circular holes in each of them”). Yet his meticulously matter-of-fact mind is also stubbornly—and painfully—inflexible. Familiar figures of speech have him foxed. Ordinary conversation and displays of emotion make him feel uncomfortable; he doesn't even like looking at other people's faces because he finds their expressions so confusing. He will simply walk away from any conversation that he is not enjoying. Noise and crowds often cause him to retreat into a corner and scream at the top of his lungs.

The story begins when Christopher discovers a neighbour's dog neatly skewered by a garden fork. A big fan of the Sherlock Holmes mysteries, Christopher resolves to find out who killed the animal, and why. Mr Haddon invests his story with humour as well as pathos. At times it makes for quite uncomfortable reading, as Christopher's investigation leads him to learn more about the break-up of his parents' marriage.

Mr Haddon's achievement is to make Christopher more than the sum of his tics; a character, not just a dramatised condition. He has given his unlikely hero a convincing voice—and the detective novel an interesting twist. For once, the pundits speak the truth.

The Curious Incident of the Dog in the Night-Time.
By Mark Haddon.
Doubleday; 236 pages; $22.95. Jonathan Cape; £10.99

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German Expressionism

The world out of joint

May 22nd 2003
From The Economist print edition

The German Expressionists are enjoying a remarkable comeback

Flavour of foreboding

THE shock of the new—that famous phrase used to describe modern art—is difficult to sustain. But the vibrant German Expressionists, with their splintered geometries, their distortions and compressions, their black silences and uneasy colours—all green streets and clocks with hands about to converge on the 12—speak so eloquently of trouble to come that even at close to a century's distance, they have the power to surprise.

Two new exhibitions, one in New York and another that is travelling from Washington, DC, to London, show how seriously early 20th-century German artists tried to explore the role of man in a perplexing, shifting society. In 1905 Ernst Ludwig Kirchner and Erich Heckel, two architecture students from Dresden, helped found a group called Die Brücke (the bridge), whose members saw art as a path taking man to a higher plane. Inspired by Nietzsche, they believed art could renew and reshape bourgeois society. They tried, and for a while succeeded, in creating an alternative exhibiting and collecting society in which both artists and patrons paid subscriptions in order to avoid the commercial taint of galleries.

The Brücke artists were driven by a belief that modern, industrial and urban life had debased individual creativity. They saw nature, and the art of what were then called primitive societies, as regenerating forces, and they spent their summers bathing in the nude and painting. To some, their noisy manifestos, elaborate staged performances and not infrequent sexual intrigues make them a parody of bohemian artists. But, in addition to a youthful idealism, the best Brücke artists—Kirchner, Heckel, Max Pechstein and Emil Nolde in particular—also shared a raw talent and a genuine belief that there was more to art than mere aesthetic experience.

The Expressionists' artistic godfathers were Albrecht Dürer, whose woodcuts inspired many of their more innovative experiments, and Edvard Munch, then already well-established in Germany and famous for his paintings of psychological intensity. In the year they launched Die Brücke, the first show of Van Gogh's works came to Dresden, opening their eyes to the expressive possibilities of colour.

Much of the best work produced in Germany at the time was done in a few short years. The first world war crushed the intensity and idealism of Die Brücke; fear, imprisonment and exile destroyed many artists afterwards. Between 1913 and 1915, when he became an “involuntary volunteer” in the German army, Kirchner created some of the 20th century's most indelible images of urban alienation, including “Potsdamer Platz, 1914” (pictured below left) and his other famous Berlin street scenes. Unable to reconcile his artistic ideals to the harsher realities of war, Kirchner suffered a nervous breakdown and moved to Davos, Switzerland, where he remained for the rest of his life and where there is a museum of his art.

Christian Schad was not part of Die Brücke, though he shared many of its aspirations and much of its talent. At their best, the bloodless portraits he painted between 1927 and 1929 suggest a deep unease and foreboding beneath their exquisite porcelain surfaces.

Kirchner's work was shown in the Nazis' infamous “Degenerate Art” exhibition. Afterwards he destroyed many of his paintings and committed suicide. A selection of carefully chosen Schad pieces were exhibited in 1937 in a show entitled “Great German Art”, the Nazis' antidote to the Degenerates' work. Guilt by association condemned Schad to a moral purgatory, and he lived in obscurity in Germany through the

war. By the time he died in 1982, his reputation had barely begun to recover.

An exhibition of Kirchner's work will travel to London's Royal Academy later in the summer, an interesting counterpoint to the Max Beckman show at Tate Modern earlier this year. Its curator, Jill Lloyd, an independent scholar of German modern art, also organised the Schad exhibition now on at the Neue Galerie, which was founded in New York by Ronald Lauder and which has done much to bring modern German art to the attention of the American public.

“We've gone past the generation of the war and there's less aggression toward all things German,” Ms Lloyd says. After the second world war, the British Museum famously refused a gift of German Expressionist graphic works. It is impossible to imagine this happening today. “These artists witnessed themselves becoming members of a lost society, whose progressive ideals were destroyed,” Ms Lloyd says. “The human content of their work is very contemporary.” For a brief moment, they sought to take on the world. At last the world is looking.

Ernst Ludwig Kirchner, National Gallery of Art, Washington, DC, until June 1st, then at the Royal Academy of Arts, London, June 28th to September 21st.

Ernst Ludwig Kirchner: “Der Maler als Bildhauer”, Staatsgalerie, Stuttgart, until July 27th.

Christian Schad, Neue Galerie, New York, until June 9th.

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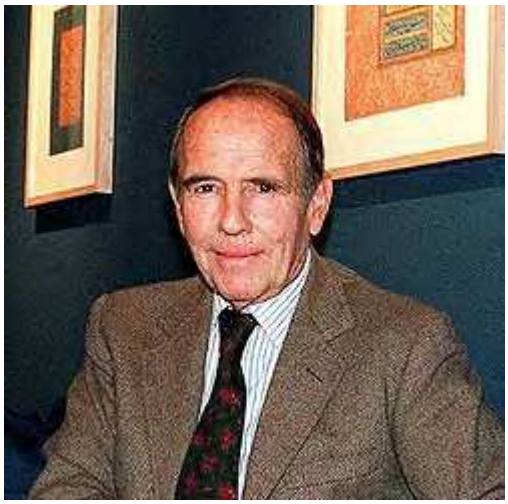
Prince Sadruddin Aga Khan

May 22nd 2003
From The Economist print edition

Prince Sadruddin Aga Khan, refugee chief, died on May 12th, aged 70

AP



IT is lunchtime at the Château de Bellerive, Prince Sadruddin Aga Khan's home on Lake Geneva. His guests are being served the elegant food associated with the prince's kitchen. But the prince and his wife Catherine are content to have a dish of brown rice and an accompanying salad. Can it be that they are not hungry, or is the prince making a gesture: that although he is a rich man he has humble tastes? No one is so impolite as to ask, but the guests may talk about it later.

The prince could be a puzzle even to those who claimed to know him well. Was he a prince at all? He was a prince of the Ismailis, a Shia Muslim sect that has some 20m followers. His father, Aga Khan III, who traced his bloodline to the Prophet Muhammad, was the leader of the Ismailis. The British royal family, which knows a thing or two about heredity, recognised Sadruddin as a true prince and he was treated accordingly.

Sadruddin (the name translates as “defender of the faith” in Arabic) was disappointed that his father did not name him as the next leader. But father apparently believed that his son lived only for pleasure. Sadruddin's much publicised life with his first wife Nina, a model, may have made it seem so. “Myths and labels become attached to people,” he remarked later, “giving them a reputation that does not always correspond to reality.” It could be that his father had mixed up Sadruddin with his half-brother Aly, who was briefly married to Rita Hayworth, a Hollywood star, and was indeed a tearaway. In the event, when the Aga Khan died in 1957, the crown, and the title Aga Khan IV, went to Sadruddin's nephew, the present holder.

Sadruddin was then 24. At that age disappointments can usually be overcome, particularly if, like the prince, you have advantages. He had had an elitist education, at Le Rosay in Switzerland and Harvard. He spoke several languages, including French from his mother, a Parisian, and Persian and English from his father. The amount of his personal fortune was unknown (like that of the Ismailis, whose followers are expected to contribute 10% of their income to the sect). But it was certainly adequate. With these assets to sustain him, Sadruddin discovered what was to be his life's work, to improve the lot of the world's refugees.

Statues and people

Like many people who came to do good work for the United Nations, Sadruddin drifted into the organisation, rather than setting out to make it his career. As a student he started an art collection that eventually became one of the finest in private hands. He recalled that at one time you could pick up a page of ancient Islam calligraphy for as little as $100, many times less than it would be worth now. He became concerned about the fate of Nubian statues threatened by the construction of the Aswan High Dam in Egypt, and in 1958 was taken on as an adviser by UNESCO, the UN's cultural branch. He discovered that the dam not only threatened Nubian statues but that some 100,000 Nubian people were being moved from their traditional homes. People were clearly more important than statues, however precious. In 1959 Sadruddin became an assistant to the United Nations High Commissioner for Refugees, and applied to the job the code of morality and responsibility of his faith. He was made deputy high commissioner in 1962 and in 1965 at the age of 32 was appointed to the top job.

The problems that followed were far graver than those of the Nubians (who were eventually resettled in

Egypt, albeit in inferior territory). Bangladesh was born in 1971 out of the break-up of Pakistan, creating hundreds of thousands of refugees. In 1973 Idi Amin expelled thousands of Asians from Uganda. At the end of the Vietnam war in 1975 thousands fled the country. And so on. He was good at getting rich countries to be generous. Perhaps only a rich man can be a successful beggar. The elder George Bush was a friend: they played tennis together. Mr Bush found the urbane European an agreeable contrast to his Texas circle.

Sadruddin stepped down after 12 years, the longest any refugee chief has held the job, but returned to the UN at times of crisis to give help, notably in Afghanistan during the Soviet occupation and Iraq after the first Gulf war. He seemed the favourite to become the UN's secretary-general in 1981, but the Soviet Union vetoed his candidature, claiming he was too pro-western, and vetoed him again in 1991. Around that time stories circulated that the prince was a secret agent for the British, using his job as a cover for intelligence gathering. It was almost certainly nonsense, but the Russians may have believed it. Sadruddin insisted that he had equal sympathies with eastern and western peoples. His description of himself as “a citizen of the world” was a fair one.

He bore this second big disappointment in his life stoically. An even greater disappointment was the realisation of how little had been done for the world's poor. In a speech not long ago he said that in 80 countries people's incomes were lower than they were ten years earlier. The number of people in poverty, earning less than $1 a day, was stuck at 1.2 billion. His meal of brown rice was a heartfelt gesture. Give him that.

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Overview

May 22nd 2003
From The Economist print edition

Fears over **deflation in America** deepened. In April, consumer prices fell by 0.3% in their first monthly decline since December 2001, thanks mostly to a fall in energy prices from their war-related highs. In the year to April, consumer-price inflation fell to 2.2% and “core” consumer-price inflation slid to its lowest level in 37 years. Not all parts of the American economy are experiencing weak inflation: in the year to April, the price of services rose by 3.2% and health-care prices rose by 4%. On the other hand, producer prices in April fell by 1.9%, the largest drop on record.

America's **M3 broad-money supply** grew by 6.5% in the year to April, unchanged from the 12 months to March.

American **consumer confidence** received a bigger boost than expected in May. The University of Michigan's consumer-confidence index rose from 86.0 in April to a preliminary estimate of 93.2 in May, thanks mostly to consumers' expectations of improvements during the next six months.

The **dollar** plunged to $1.17 against the **euro**, a four-year low, before rebounding slightly. America's Treasury Secretary, John Snow, seemed to herald the end of America's eight-year-old “strong dollar” policy by saying that the market value of the dollar was not as important as overall “confidence” in the currency.

The EuroCOIN indicator, a measure of **euro-area economic growth** released by Britain's Centre for Economic Policy Research, indicated continued stagnation in the euro area's GDP in April.

In the first quarter of this year, the **French economy** grew by 0.3%. In the year to the first quarter, France's economy grew by 1.0%. During the same period, the **euro area's** economy grew by 0.8%. Industrial production in the euro area fell by 0.3% in the year to March. In **the Netherlands**, unemployment rose in April to 5.1%. Producer prices in **Germany** fell by 0.2% in April compared with expectations of a drop twice that size; Germany's economy was cited by the IMF as having a high risk of falling into deflation.

Consumer-price inflation ran at 3.1% in **Britain** in April, up from 1.5% a year ago.

Japan's economy was stagnant in the first quarter, ending three straight quarters of growth.

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Output, demand and jobs

May 22nd 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.0	Q4	+ 1.6	+ 3.0	+ 3.5	+ 2.3	Q4	+ 4.0	Q1	6.1	Apr	6.3
Austria	+ 1.3	Q4	– 0.5	+ 0.9	+ 1.8	– 1.5	Dec	+ 0.9	Dec	4.3	Mar	4.0
Belgium	+ 1.7	Q4	+ 1.2	+ 1.1	+ 2.1	– 0.1	Mar	– 5.3	Feb	11.6	Apr†	10.5
Britain	+ 2.3	Q1	+ 0.7	+ 1.8	+ 2.4	– 0.8	Mar	+ 2.7	Apr	5.1	Mar††	5.1
Canada	+ 3.9	Q4	+ 1.6	+ 2.7	+ 3.2	+ 1.9	Feb	+ 2.2	Feb	7.5	Apr	7.6
Denmark	+ 0.9	Q4	– 0.1	+ 1.5	+ 2.2	– 1.6	Mar	+ 5.8	Feb	5.8	Mar	5.0
France	+ 1.0	Q1	+ 1.0	+ 1.2	+ 2.1	+ 0.5	Mar	– 0.8	Feb	9.3	Mar	8.9
Germany	+ 0.2	Q1	– 0.9	+ 0.4	+ 1.5	– 0.4	Mar	– 4.0	Mar	10.7	Apr§	9.6
Italy	+ 0.8	Q1	– 0.4	+ 1.0	+ 1.9	– 0.7	Mar	+ 0.8	Feb†	9.0	Jan	9.0
Japan	+ 2.7	Q1	nil	+ 0.7	+ 0.8	+ 3.8	Mar	– 0.8	Mar	5.4	Mar	5.3
Netherlands	– 0.3	Q1	– 1.2	+ 0.5	+ 1.6	– 5.6	Mar	– 2.5	Dec	5.1	Apr**	3.8
Spain	+ 2.1	Q4	+ 1.4	+ 2.1	+ 2.6	+ 9.5	Mar	+ 2.3	Feb	11.5	Mar	11.2
Sweden	+ 1.3	Q4	+ 1.2	+ 1.5	+ 2.3	– 3.9	Mar	+ 2.6	Mar	4.6	Mar†	3.8
Switzerland	+ 0.8	Q4	+ 1.4	+ 0.8	+ 1.6	– 2.1	Q4	– 1.3	Jan	3.9	Apr†	2.5
United States	+ 2.1	Q1	+ 1.6	+ 2.2	+ 3.2	– 0.4	Apr	+ 4.6	Mar	6.0	Apr	5.9
Euro area	+ 0.8	Q1	nil	+ 1.1	+ 2.1	– 0.3	Mar	+ 0.7	Feb	8.7	Mar	8.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.8	Q4	+ 2.8	na	na	– 2.0	Mar	+ 4.9	Feb	10.4	Apr†	10.4
Greece	+ 3.5	Q4	na	na	na	+ 0.8	Mar	na		na		na
Iceland	– 3.0	Q4	na	na	na	– 0.3	2002	na		3.9	Apr†	2.6
Ireland	+ 6.4	Q4	na	na	na	+14.3	Feb	– 2.0	Feb	4.6	Apr	4.2
Luxembourg	+ 1.0	2001	na	na	na	– 2.1	Feb	+ 9.7	Dec	3.7	Mar	2.8
New Zealand	+ 4.2	Q4	+ 2.0	na	na	+ 5.9	Q4	+ 7.3	Q4	4.9	Q4	5.4
Norway	– 0.1	Q4	+ 0.9	na	na	+ 9.0	Mar	+ 0.9	Mar	4.4	Q1	4.1
Portugal	– 1.3	Q4	– 3.1	na	na	– 4.5	Mar	+ 2.3	Feb	6.2	Q4†	4.2

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Jan-Mar; claimant count rate 3.1% in Apr. §EU harmonised rate 9.4% in April. **Feb-Apr.

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Prices and wages

May 22nd 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 3.4	Q1	+ 2.9	+ 2.7	+ 2.5	+ 3.0	Q1	+ 0.5	+ 3.9	Q4	+ 4.9
Austria	+ 1.3	Apr	+ 1.8	+ 1.5	+ 1.3	+ 0.8	Apr	– 0.5	+ 2.2	Apr	+ 2.4
Belgium	+ 1.5	Apr	+ 1.8	+ 1.4	+ 1.4	+ 0.8	Mar	– 0.9	+ 2.4	Q1	+ 3.1
Britain	+ 3.1	Apr	+ 1.5	+ 2.8	+ 2.4	+ 1.7	Apr	+ 0.2	+ 3.4	Mar	+ 2.9
Canada	+ 4.3	Mar	+ 1.8	+ 3.1	+ 2.2	+ 1.3	Mar	– 1.0	+ 2.1	Feb	+ 3.5
Denmark	+ 2.5	Apr	+ 2.4	+ 2.3	+ 1.9	– 0.5	Apr	+ 0.3	+ 3.9	Q4	+ 4.1
France	+ 2.0	Apr	+ 2.0	+ 1.8	+ 1.4	+ 2.5	Mar	– 0.8	+ 3.5	Q4	+ 3.9
Germany	+ 1.0	Apr	+ 1.5	+ 1.1	+ 0.9	+ 0.3	Apr	– 0.5	+ 2.6	Feb	+ 2.5
Italy	+ 2.7	Apr	+ 2.3	+ 2.3	+ 1.9	+ 2.8	Mar	– 0.8	+ 1.7	Mar*	+ 2.1
Japan	– 0.1	Mar	– 1.2	– 0.6	– 0.5	– 0.8	Apr	– 2.3	+ 2.5	Mar	– 0.9
Netherlands	+ 2.5	Apr	+ 3.5	+ 2.5	+ 2.1	+ 3.5	Mar	– 1.7	+ 2.8	Mar	+ 4.4
Spain	+ 3.1	Apr	+ 3.6	+ 3.0	+ 2.6	+ 3.0	Mar	– 0.1	+ 3.9	Q4	+ 3.7
Sweden	+ 2.3	Apr	+ 2.5	+ 2.4	+ 1.8	+ 0.6	Mar	– 0.4	+ 2.1	Feb	+ 3.3
Switzerland	+ 0.7	Apr	+ 1.1	+ 0.8	+ 0.9	– 0.3	Apr	– 1.4	+ 1.8	2002	+ 2.5
United States	+ 2.2	Apr	+ 1.6	+ 2.3	+ 1.7	+ 2.4	Apr	– 2.1	+ 3.1	Apr	+ 3.2
Euro area	+ 2.1	Apr	+ 2.3	+ 1.9	+ 1.5	+ 2.4	Mar	– 0.8	+ 3.4	Q4	+ 3.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.1	Apr	+ 1.8	na	na	+ 0.8	Mar	– 0.8	+ 3.3	Q4	+ 4.5
Greece	+ 4.1	Mar	+ 4.0	na	na	+ 2.0	Mar	+ 4.2	na		na
Iceland	+ 2.2	May	+ 5.9	na	na	+ 3.3	Apr	+ 8.7	+ 5.7	Mar	+ 8.7
Ireland	+ 4.9	Mar	+ 4.8	na	na	– 7.1	Mar	+ 0.7	+ 6.8	Q4	+ 7.8
Luxembourg	+ 2.2	Apr	+ 2.1	na	na	+ 2.3	Feb	– 2.4	– 0.4	Feb	+ 2.5
New Zealand	+ 2.5	Q1	+ 2.6	na	na	– 0.9	Q4	+ 1.8	+ 2.3	Q1	+ 2.1
Norway	+ 2.9	Apr	+ 0.5	na	na	+ 5.1	Mar	– 4.5	+ 5.2	Q4	+ 4.4
Portugal	+ 3.9	Mar	+ 3.2	na	na	+ 2.0	Apr	+ 0.2	+ 0.6	Feb	+ 0.6

*New series.

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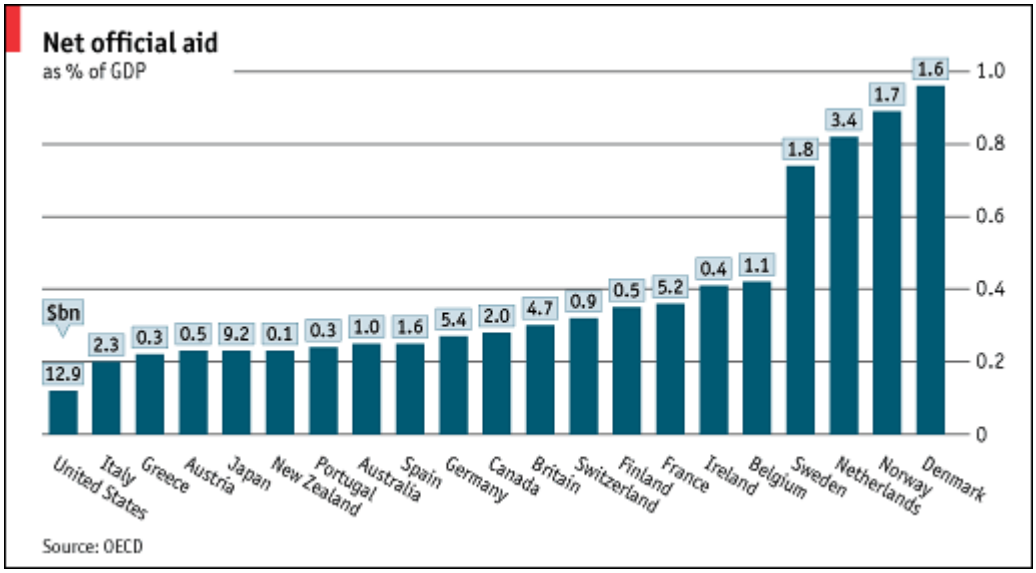
Net official aid

May 22nd 2003
From The Economist print edition



Rich-country donors that form the OECD's Development Assistance Committee increased their official aid to poor countries by 4.8% in real terms (to $57 billion) in 2002. Even so, most of the countries on our chart still fall short of the United Nations' aid targets, except Denmark, Norway, the Netherlands and Sweden. In dollar terms, America, which gives away only 0.12% of its GDP in aid, remains the world's biggest donor.

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Money and interest rates

May 22nd 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (May 21st 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	–10.0	+10.6	Mar	4.71	4.90	4.46	4.90	6.23	5.70
Britain	+ 8.6	+ 7.9	Apr	3.56	4.13	3.22	4.03	5.24	5.58
Canada	+ 7.0	+ 4.9	Mar	3.20	2.60	3.40	4.62	5.62	6.52
Denmark	+ 8.2	+ 9.2	Mar	2.60	3.80	2.36	3.91	5.33	5.26
Japan	+ 4.7	+ 1.4	Apr	0.02	0.02	0.04	0.58	1.38	0.69
Sweden	+ 2.2	+ 5.9	Mar	3.16	4.24	3.12	4.16	5.58	3.56
Switzerland	+27.5	+11.3	Apr	0.28	1.24	0.29	2.16	3.28	3.10
United States	+ 5.3	+ 6.5	Apr	1.20	1.80	1.32	3.38	5.10	5.34
Euro area†	+11.6	+ 7.9	Mar	2.37	3.49	2.13	3.68	5.09	3.90

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.35%, Japan No.249 0.57%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.50%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

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1995=100

	May 6th*	May 13th	May 20th†	% change on one month	% change on one year
Dollar index					
All items	75.5	77.2	77.7	+ 1.7	+12.8
Food	78.0	80.2	80.2	+ 2.8	+15.3
Industrials					
All	72.0	73.2	74.2	+ 0.2	+ 9.4
Nfa‡	74.3	74.0	76.3	– 3.5	+11.6
Metals	70.0	72.5	72.4	+ 3.7	+ 7.5
Sterling index					
All items	73.7	75.7	74.9	– 1.9	+ 0.4
Euro index					
All items	87.5	88.2	87.7	– 4.3	–11.1
Yen index					
All items	94.7	95.8	96.5	– 0.8	+ 6.2
Gold					
$ per oz	342.90	350.70	367.75	+ 9.9	+16.1
West Texas Intermediate					
$ per barrel	25.73	28.57	29.10	– 2.7	+ 7.9

* Revised. † Provisional. ‡ Non-food agriculturals.

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Stockmarkets

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From The Economist print edition

Market indices

	May 21st	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	2,914.9	3,049.6	2,673.3	- 1.0	-15.3	- 2.0	+14.2
Austria (ATX)	1,310.4	1,325.7	1,120.2	- 0.8	-24.6	+13.9	+27.0
Belgium (Bel 20)	1,877.8	2,074.1	1,426.6	- 2.7	-49.0	- 7.3	+ 3.4
Britain (FTSE 100)	3,936.4	4,049.0	3,287.0	- 1.0	-43.2	- 0.1	+ 2.0
Canada (Toronto Composite)	6,726.4	6,837.3	6,228.6	- 0.2	-40.9	+ 1.7	+19.0
Denmark (KBX)	179.3	180.1	145.0	+ 1.3	-40.6	+ 7.8	+20.3
France (SBF 250)	1,949.8	2,144.8	1,630.1	- 2.7	-55.6	- 5.0	+ 5.8
(CAC 40)	2,881.2	3,210.3	2,403.0	- 2.7	-58.4	- 6.0	+ 4.8
Germany (DAX)	2,827.3	3,157.3	2,203.0	- 3.4	-64.9	- 2.3	+ 8.9
Italy (BCI)	1,094.2	1,142.4	959.4	- 2.5	-49.9	+ 0.2	+11.7
Japan (Nikkei 225)	8,018.5	8,790.9	7,607.9	- 2.7	-79.4	- 6.5	- 5.5
(Topix)	809.8	865.4	770.6	- 2.7	-71.9	- 4.0	- 2.9
Netherlands (AEX)	268.6	337.3	218.4	- 4.8	-61.7	-16.8	- 7.2
Spain (Madrid SE)	650.1	684.6	576.8	- 2.4	-43.3	+ 2.5	+14.3
Sweden (Affarsvarlden Gen)	143.8	153.4	127.8	- 4.7	-64.1	- 1.0	+10.2
Switzerland (Swiss Market)	4,450.6	4,965.3	3,675.4	- 2.1	-47.1	- 3.9	+ 2.9
United States (DJIA)	8,516.4	8,842.6	7,524.1	- 1.5	-27.4	+ 2.1	+ 2.1
(S&P 500)	923.4	946.7	800.7	- 1.7	-39.5	+ 5.0	+ 5.0
(NASDAQ Comp)	1,489.9	1,551.4	1,271.5	- 2.9	-70.5	+11.6	+11.6
Europe (FTSE Eurotop 300) *	797.7	890.8	682.7	- 2.4	-53.2	- 6.9	+ 3.7
Euro area (FTSE Ebloc 100)*	674.4	757.2	565.7	- 3.2	-56.5	- 6.1	+ 4.6
World (MSCI) †	826.2	844.3	710.8	- 1.4	-43.0	na	+ 4.3
World bond market (Citigroup)‡	573.5	573.5	518.6	+ 1.4	nil	na	+ 9.2

*In euro terms. † Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

May 22nd 2003
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	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2003	2004	Exchange rate trade-weighted† 1990=100 May 21st	year ago	Currency units per $ May 21st	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2003‡
Australia	− 7.8	Mar	− 17.7	Q4	− 4.7	− 4.0	81.6	76.7	1.52	1.79	2.50	1.78	1.30	0.2
Austria	+ 0.7	Feb	+ 1.4	Mar	− 0.1	− 0.2	102.0§	100.1	0.85	1.08	1.41	–	0.73	-1.3
Belgium	+ 16.4	Mar	+ 11.4	Jan	+ 5.0	+ 5.0	102.0§	98.8	0.85	1.08	1.41	–	0.73	nil
Britain	− 56.8	Mar	− 13.1	Q4	− 1.6	− 1.4	98.3	104.2	0.61	0.69	–	0.71	0.52	-1.9
Canada	+ 36.4	Mar	+ 11.0	Q4	+ 1.5	+ 1.6	86.3	78.0	1.35	1.54	2.22	1.58	1.15	1.1
Denmark	+ 8.7	Mar	+ 5.5	Mar	+ 2.3	+ 2.2	106.7	102.3	6.35	8.03	10.4	7.42	5.41	1.6
France	+ 8.4	Mar	+ 28.6	Mar	+ 1.8	+ 1.5	105.2§	101.4	0.85	1.08	1.41	–	0.73	-3.6
Germany	+123.0	Mar	+ 48.0	Mar	+ 1.9	+ 1.6	102.5§	98.2	0.85	1.08	1.41	–	0.73	-3.7
Italy	+ 6.0	Mar	− 9.6	Feb	− 0.3	− 0.3	75.0§	72.3	0.85	1.08	1.41	–	0.73	-2.4
Japan	+ 94.7	Mar	+109.9	Mar	+ 2.7	+ 2.9	128.4	133.6	117	124	193	137	–	-7.7
Netherlands	+ 28.5	Mar	+ 2.9	Q1	+ 3.1	+ 3.1	101.4§	97.7	0.85	1.08	1.41	–	0.73	-1.6
Spain	− 42.0	Feb	− 18.2	Feb	− 2.2	− 2.1	76.4§	74.1	0.85	1.08	1.41	–	0.73	-0.4
Sweden	+ 15.2	Mar	+ 9.9	Dec	+ 3.6	+ 3.5	80.9	76.8	7.83	9.9	12.9	9.16	6.67	0.7
Switzerland	+ 5.0	Apr	+ 32.0	Q4	+11.7	+11.7	115.0	114.4	1.29	1.57	2.12	1.51	1.10	na
United States	−514.3	Mar	−503.4	Q4	− 5.3	− 5.4	101.7	117.1	–	–	1.64	1.17	0.85	-4.6
Euro area	+ 87.2	Mar	+ 53.1	Feb	+ 0.8	+ 0.7	91.0	80.0	0.85	1.08	1.41	–	0.73	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.3	Mar	+ 9.9	Mar	na	na	81.0§	77.8	0.85	1.08	1.41	–	0.73	3.1
Greece	− 22.8	Mar	− 11.1	Mar	na	na	59.0§	57.4	0.85	1.08	1.41	–	0.73	-1.0
Iceland	+ 0.2	Mar	nil	Q4	na	na	96.0**	84.9	72.7	92.8	120	85.0	62.0	nil
Ireland	+ 36.3	Feb	− 0.2	Q4	na	na	93.0§	86.9	0.85	1.08	1.41	–	0.73	-0.8
Luxembourg	− 3.0	Jan	+ 1.7	Q4	na	na	102.0§	98.8	0.85	1.08	1.41	–	0.73	0.2
New Zealand	− 0.9	Mar	− 1.9	Q4	na	na	98.1	88.1	1.71	2.12	2.82	2.00	1.46	0.8
Norway	+ 27.9	Apr	+ 28.1	Feb	na	na	102.9	102.9	6.71	8.08	11.0	7.85	5.72	11.3
Portugal	− 12.5	Feb	− 8.8	Feb	na	na	92.2**	90.1	0.85	1.08	1.41	–	0.73	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, March average. ‡OECD forecast. **IMF, January average.

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Government budget balances

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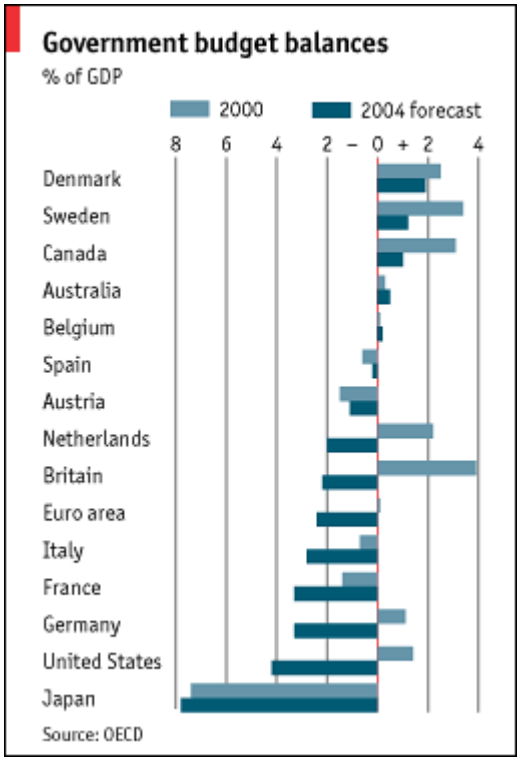

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Overview

May 22nd 2003
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Argentina's economy is rebounding strongly from its recession and financial crisis. GDP grew by 5.2% in the year to the first quarter.

Indonesia's economy grew by 3.4% in the year to the first quarter. During the same period, **Tawain's** GDP rose by 3.2% and **Singapore's** by an upwardly revised 1.6%.

Industrial output in the year to April grew by 7.1% in **Russia** and by 14.9% in **China**.

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Catastrophes

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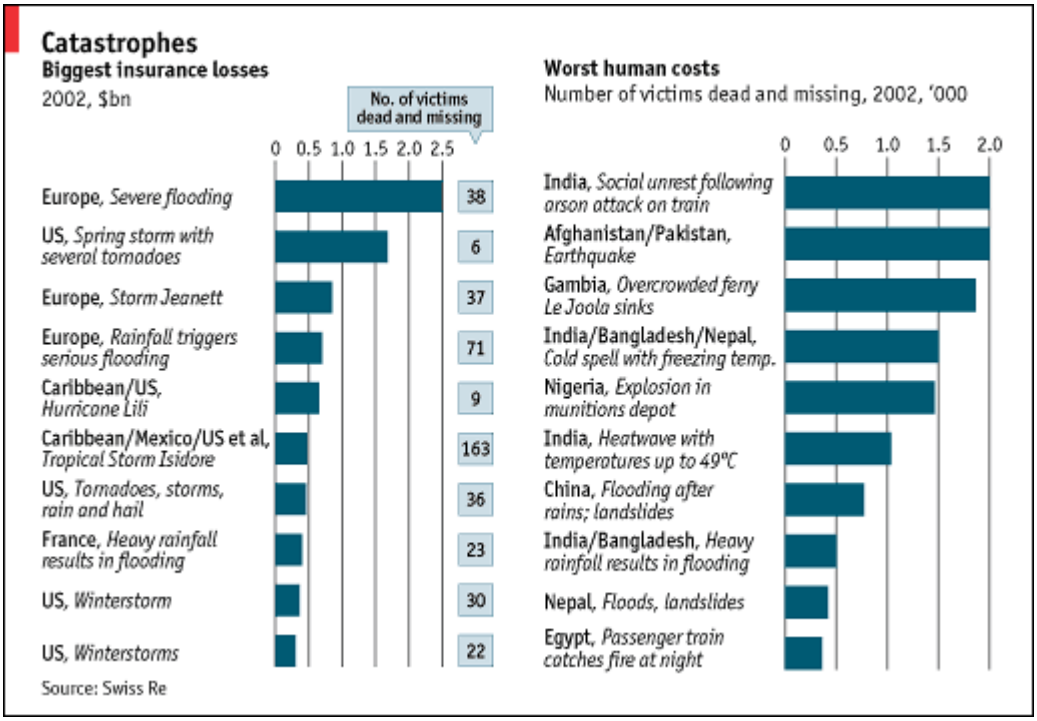

Terrorist attacks in 2001 caused the biggest insurance losses ever from man-made events. Last year, however, saw a return to “normal”, as insurers suffered their biggest losses as a result of natural disasters, such as floods in Europe, spring storms in America and hurricanes in the Caribbean. India registered the highest death toll from any single catastrophe, when 2,000 people died in social unrest following an arson attack.

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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q1	+14.9	Apr	+ 1.0	Apr	+22.0	Apr	+33.5	2002†	312.9	Feb
Hong Kong	+ 5.0	Q4	– 9.2	Q4	– 2.1	Mar	– 8.0	Mar	+13.8	Q4	114.2	Apr
India	+ 2.6	Q4	+ 6.4	Feb	+ 4.1	Mar	– 9.0	Mar	+ 4.8	Q4	71.1	Mar
Indonesia	+ 3.4	Q1	+29.2	Feb	+ 7.5	Apr	+25.6	Mar	+ 7.1	Q3	31.6	Mar
Malaysia	+ 5.6	Q4	+ 5.0	Mar	+ 1.0	Apr	+14.7	Mar	+ 7.3	Q4	33.8	Mar
Philippines	+ 5.8	Q4	+ 1.8	Feb	+ 2.8	Apr	– 0.1	Mar	+ 4.2	Dec	13.1	Apr
Singapore	+ 1.6	Q1	+ 6.5	Mar	+ 0.8	Mar	+11.1	Mar	+18.7	Q4	83.4	Apr
South Korea	+ 3.7	Q1	+ 4.5	Mar	+ 3.7	Apr	+ 7.8	Apr	+ 2.9	Mar	123.6	Apr
Taiwan	+ 3.2	Q1	+ 1.6	Mar	– 0.1	Apr	+16.5	Apr	+26.0	Q1	168.6	Mar
Thailand	+ 6.1	Q4	+12.7	Mar	+ 1.6	Apr	+ 3.9	Mar	+ 8.5	Mar	36.8	Mar
Argentina	+ 5.2	Q1	+15.8	Mar	+19.4	Apr	+16.7	Mar	+ 8.9	Q4	11.0	Apr
Brazil	+ 3.4	Q4	+ 3.5	Mar	+17.4	Apr	+17.1	Apr	– 4.4	Mar	42.3	Mar
Chile	+ 3.5	Q1	+ 6.9	Mar	+ 4.0	Apr	+ 2.3	Apr	– 0.6	Q4	16.1	Mar
Colombia	+ 2.0	Q4	+ 5.0	Feb	+ 7.8	Apr	– 0.4	Feb	– 1.6	Q4	10.5	Apr
Mexico	+ 2.3	Q1	+ 3.8	Mar	+ 5.3	Apr	– 6.7	Mar	–14.5	Q4	53.7	Apr
Peru	+ 5.2	Mar	+ 4.2	Feb	+ 2.6	Apr	+ 0.3	Mar	– 1.1	Q4	9.8	Apr
Venezuela	–16.7	Q4	–64.8	Dec	+33.5	Apr	+13.9	Q4	+ 7.6	Q4	8.4	Feb
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.1	Feb	– 7.4	Jan	+ 0.5	Q4	13.1	Apr
Israel	+ 1.3	Q4	+ 3.0	Jan	+ 3.1	Apr	– 5.8	Apr	– 2.1	Q4	23.4	Apr
South Africa	+ 3.0	Q4	– 0.7	Mar	+12.5	Mar	+ 3.6	Mar	+ 0.3	Q4	6.1	Mar
Turkey	+11.4	Q4	+ 5.6	Mar	+29.5	Apr	–16.4	Feb	– 2.7	Feb	26.9	Mar
Czech Republic	+ 1.5	Q4	+ 7.0	Mar	– 0.1	Apr	– 2.6	Mar	– 3.5	Q4	24.6	Apr
Hungary	+ 3.7	Q4	+ 4.2	Mar	+ 3.9	Apr	– 2.5	Mar‡	– 3.3	Mar	12.8	Apr
Poland	+ 2.1	Q4	+ 5.7	Mar	+ 0.3	Apr	– 9.9	Mar	– 5.8	Mar	29.9	Apr
Russia	+ 5.2	Q4	+ 7.1	Apr	+14.7	Apr	+52.2	Mar	+38.3	Q1	56.1	Apr
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	+15.8	Nov	+ 2.2	Apr	– 1.5	Apr	+ 2.7	2002†	10.3	Mar
Saudi Arabia	+ 0.7	2002†	na		– 0.9	Jan	+38.6	2002†	+ 9.5	2002†	22.8	Mar

*Excluding gold, except Singapore; IMF definition. †EIU est. ‡Year ending June. ‡New series.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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Financial markets

May 22nd 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	May 21st		Dec 31st 2002	
	May 21st	year ago	May 21st	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.6	na	1,605.7	+0.7	+ 13.1	+ 13.2
Hong Kong	7.80	7.80	12.8	1.33	9,059.8	-0.5	- 2.8	- 2.8
India	46.8	49.0	77.0	4.94	3,057.1	+2.1	- 9.5	- 7.3
Indonesia	8,325	9,065	13,685	11.33	466.3	-0.4	+ 9.7	+ 18.0
Malaysia	3.80	3.80	6.25	3.10	640.4	+0.7	- 0.9	- 0.9
Philippines	52.6	49.8	86.5	8.56	1,046.2	-1.5	+ 2.7	+ 4.2
Singapore	1.73	1.79	2.84	0.63	1,290.7	-1.5	- 3.8	- 3.2
South Korea	1,194	1,237	1,963	4.32	600.6	-1.5	- 4.3	- 5.0
Taiwan	34.6	34.3	56.9	1.25	4,216.6	-2.9	- 5.3	- 4.8
Thailand	42.0	42.8	69.0	1.75	387.4	+0.6	+ 8.7	+ 11.6
Argentina	2.86	3.44	4.70	5.70	634.1	+0.6	+ 20.8	+ 42.2
Brazil	3.01	2.50	4.96	26.32	13,033.7	-3.2	+ 15.7	+ 35.8
Chile	711	655	1,169	2.76	5,704.4	-2.9	+ 13.6	+ 15.0
Colombia	2,914	2,343	4,789	7.79	1,834.5	+1.4	+ 14.0	+ 12.2
Mexico	10.23	9.52	16.8	5.35	6,410.8	-2.1	+ 4.6	+ 7.1
Peru	3.49	3.47	5.73	3.74	1,787.5	+0.5	+ 28.4	+ 29.4
Venezuela	1,598	997	2,627	22.72	9,270.3	+5.8	+ 15.7	+ 0.4
Egypt	5.96	4.63	9.79	11.50	7,810.2	+5.2	+ 45.4	+ 13.1
Israel	4.58	4.87	7.53	5.51	384.8	-7.7	+ 15.7	+ 20.0
South Africa	7.7	10.1	12.7	13.50	8,108.5	+0.9	- 12.6	- 3.2
Turkey	1,503,000	1,413,500	2,470,631	39.00	10,540.9	+1.4	+ 1.6	+ 12.3
Czech Republic	26.9	33.2	44.2	2.44	551.3	+0.9	+ 19.7	+ 33.9
Hungary	210	261	346	6.45	8,340.5	+2.2	+ 7.0	+ 14.3
Poland	3.74	4.08	6.14	5.53	14,891.7	-0.8	+ 3.7	+ 6.4
Russia	30.9	31.3	50.8	18.00	442.6‡	+1.2	+ 19.1	+ 23.3
EMF (MSCI)*	1.00	1.00	1.64	na	300.3	-1.6	na	+ 2.8
EMBI+†	1.00	1.00	1.64	na	269.4	-0.5	na	+ 17.7

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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